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LEGAL AND REGULATORY ASPECTS OF FINANCING COMMODITY EXPORTERS AND THE PROVISION OF BANK HEDGING LINE CREDIT IN DEVELOPING COUNTRIES

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Legal and Regulatory Aspects of Financing Commodity Exporters and the Provision of Bank Hedging Line Credit in Developing Countries

Nicholas Budd

The ability of raw materials and commodity exporters in developing countries to produce and market their products in an efficient manner depends on the availability of hard currency pre-export financing and the adoption of pricing policies which meet the requirements of the international marketplace. The author has identified a number of structural obstacles which impede access both to international financing and to price risk management tools which could be overcome through relatively simple modifications in export regulations, currency controls, insurance regulations and in laws concerning title to goods.

The purpose of this paper is to describe the special problems faced by developing country commodity producers and exporters, both private and government-owned, in obtaining pre-export financing for stocks and for financing and managing hedging operations related to these commodities. For purposes of illustration, the discussion will focus on the African coffee export trade, however the same principles apply to other widely traded soft commodities (cocoa, sugar, cotton), to grains and oilseeds, to base metals, to most energy commodities, and to producers, refiners and exporters in Latin America and the new market economies of eastern and central Europe and Asia.

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It will be attempted to offer practical solutions to these problems, and where appropriate government policies will be suggested which would greatly assist exporters and banks to obtain necessary financing, maximize export revenues, and manage commodity price risk.

It is clear that, for coffee and other commodities traded in the futures markets, cost-efficient financing, export revenue optimization and price risk management are very much related issues, and in dealing with any of these three issues one is inevitably drawn into the remaining two.

Commercial Financing and Hedging of Coffee

Coffee financing is attractive to lenders because of the existence of a large and organised market, high unit prices which result in relatively large loans, the availability of efficient means of hedging against decline in collateral value, and professional organisations which can verify grade and quality in every major producing country. Coffee is typically sold for hard currencies to large traders or roasters which present no substantial credit and collection risk to the lender once the coffee is delivered. As a high value commodity, suitable pre-shipment storage space is generally available for coffee, and is carefully controlled. In general, a commercial lender or provider of hedging lines relying on inventory and trade receivables as security could wish for no better collateral than physical coffee and related trade receivables and hedging contracts. Most commodity bankers would agree that if physical coffee can be graded, controlled, insured and hedged against price declines, and eventually delivered to known international buyers, the coffee would provide acceptable collateral for cash advances and for credit to cover hedging margin requirements.

Demand for Financing African coffee producers and exporters have a strong and logical need for hard currency financing. Many of the inputs, namely fertilizers, fungicides, pesticides, packing materials, and related equipment and spare parts, are imported and require hard currency for payment. Coffee is exported and generates hard currency earnings, and generally it is prudent to finance working capital requirements in the same currency as sales. Hedging contracts on commodity exchanges or over the counter are denominated in hard currency and deposits and variation margins are required to be posted in hard currency. Perhaps most importantly, hard currency real interest rates are normally much lower than local rates, due to the adoption of measures to moderate inflation and resulting shortage of bank liquidity in relation to the demand for bank credit.

Distinctions between Stock Financing and Hedge Line Credits A distinction should be drawn here between stock financing lines and hedging lines. Stock financing will normally be provided by banks or trading companies, although it is not unknown for large commodity brokers to provide stock financing in very standardized situations. Hedging lines, that is, credit to cover initial or variation margins or to purchase options or other derivatives, can either be provided by banks or by brokers. Although brokers may not be subject to the same country limit lending limitations as the banks, and theoretically may have the ability to make larger lines available, in practice the brokers are not set up to document and monitor the complex credit and security arrangements necessary to structure large facilities. Coffee producers requiring hedging credit are left with the choice between small facilities from a number of brokers, and larger facilities from a single bank. If the bank is providing stock financing, it might insist on providing the hedging line as well in order to monitor the hedging operation and to protect the producer and the loan against speculation.

Restrictions on Stock Financing and Hedging Line Credit Despite the attractiveness of coffee and export receivables as collateral, and the appropriateness of hard currency borrowing, African coffee producers and exporters face significant obstacles in arranging the necessary trade and hedge line credits.

Country Credit Limits Part of the problem lies in the overall country credit limits imposed by international banks, over which exporters have no practical control. However, many banks distinguish between pure credit risks (for example, providing a confirmation of a local bank letter of credit), and loans which depend for repayment upon the performance of a commercial operation (for example, a pre-export advance to a coffee producer which will be repaid from the proceeds of the shipment of coffee). For many banks, loans depending upon performance may be exempted from country credit limitations and are analyzed in terms of the exporter's ability of perform its commercial obligations. The stronger the exporter's motivation and ability to perform, the more likely the loan will be granted. Also, "Performance risk" credits are more likely to be insurable under political risk insurance policies, which are discussed in more detail below.

Lack of Trade Credit For most of the past fifty years international commodity trading companies were the traditional providers of credit to commodity producers, and it was the traders who essentially re-lent funds provided under their own credit lines. Normally the banks would not scrutinize terms and conditions of credit transactions between the trader and the exporter, as the bank depended upon the trader for repayment and trusted the trader to operate its business prudently. This arrangement was advantageous to producers generally, as many trading companies would extend credit in the form of pre-payments on the strength of established business relationships with minimal security and documentation. During the past ten years, however, with the demise of a number of substantial commodity trading companies and resulting large loan losses, many banks have withdrawn from commodity financing and those which remain insist that the documentation, security and credit controls meet banking standards rather than trading standards. Trading company managers, in the meantime, have become much more conservative in providing pre-shipment advances, and wherever possible ask the banks to extend loans to producers on a non-recourse basis. The distinctions between bank credit and trade credit from international buyers have therefore become less and less significant and both are subject to the same limitations.

Local Structural Limitations The difficulties in arranging bank and trade credit facilities are increased, and sometimes related to, local structural problems which a lender encounters when attempting to prepare a coffee financing proposal acceptable to a bank credit committee. However, unlike country credit limits and reduction of trade credit, these are matters over which the exporter and the exporting country definitely do have control, and which be will be the main matters covered by the remainder of this atricle.

Structural Impediments to Provision of Stock Financing and Hedging Line Credits In the remainder of this paper the main problems banks and commodity brokers face in providing finance and hedging facilities to African coffee exporters will be considered and some practical means of overcoming these problems offered. Some or all of these structural problems are encountered in every commodity exporting country in the developing world, although the extent and composition vary from country to country.

1. **The Commercial Law** Commercial financing, whether it be for the purpose of stock financing or for financing hedge lines, requires a legal system which deals clearly and practically with various issues. Any lack of certainty as to the rights of the parties or anticipated delay in enforcement leads, at the minimum, to a "risk premium," and often an inability to structure the transaction in a manner which would be most useful to the exporter and the country as a whole. These important legal issues are set forth below.

a. **The Law Relating to Security and Title to Goods** It is fundamental that commodity financing is secured financing, and the lender must be able to either take outright legal title or a first security interest in the commodity which enables the lender to seize, export and sell the commodity in the event of a loan default. The commercial law must clearly cover the following issues in a manner which is practical and inexpensive for the parties:

i) **Acquisition and Transfer of Title** The commercial law should provide that title to goods passes upon execution of a signed agreement which states that the parties intend to pass title and identifies the goods, whether or not the full purchase price has been paid. This enables clear title to be passed, if the parties so agree, in cases where the financier makes a partial prepayment pending export.

ii) **Title to goods in Bulk** The commercial law should provide that good title can pass while the goods remain part of a commingled mass of fungible goods. For example, an exporter holding two tons of coffee in a warehouse should be able to pass title to a one ton parcel without segregating the coffee. For many years this was not possible in countries following English commercial law rules, but fortunately this problem has finally been addressed in England and should be followed in other countries which have adopted the English common law system.

iii) **Title to Growing Crops or Commodities not yet Extracted** The law should provide that title to growing crops or other raw materials in the ground can be passed at the time the advance is made and continues with respect to the products and proceeds. In such cases, the bill of sale should require registration in the local land registry to give notice to third party purchasers or encumbrancers.

iv) **Documents of Title and Field Warehousing** There must be a clear and concise law relating to the issuance and transfer of documents of title, notably warehouse receipts, which enables purchasers in good faith to take clear title to goods upon delivery of a title document issued by a legally recognized custodian. The laws relating to documents of title should enable legally independent warehouses to be established within storage facilities owned by the producer or exporter, so long as the storage area is controlled by an independent and licensed trustee or warehouse company (a practice commonly known as "field warehousing").

As a related matter, it is desirable that the country enacts strict laws concerning the qualifications, professional liability insurance, operation and supervision of public warehouses, freight forwarders and other custodians.

v) **Creation and Registration of Security Interests** Just as the law should enable purchasers of goods to be certain that they have obtained good and unencumbered title, so the law should enable lenders to take a charge over growing crops, raw materials in the ground and physical stocks, as well as related export receivables. It should be legally possible for the producer or exporter to grant a first security interest over a) all of its stocks wherever located and whenever acquired, and the products and sale and insurance proceeds, or b) certain specified stocks which are identified by location. It should be possible for the producer to grant charges to several lenders, which will have priority depending upon the time of registration or as agreed among the lenders. Charges should be created upon execution by the producer/borrower of a form set out in the law, upon registration of this document with an official registrar. There should be no significant stamp duties, notarial fees or other taxes payable in respect of registration of charges. Countries which do not have a clear commercial law enabling the creation of reliable security interests by registration are at an enormous competitive disadvantage in attracting hard currency financing.

b. **Bankruptcy Laws** The bankruptcy laws of the country should make it clear that purchasers of goods who have acquired good title can dispose of the goods free of any claims of the seller's creditors or of the creditors of any warehouse operator or other custodian, subject to payment of any remaining amount due under the sales contract or custodial fees. The bankruptcy law must provide clearly that the holder of a senior security interest in goods, trade receivables, insurance proceeds, etc. may dispose of the goods and collect the proceeds free of claims of junior creditors, and, in the case of foreign currency advances, export the goods for sale abroad, provided that the manner of disposal is commercially reasonable and that the creditor accounts to the court for any excess proceeds recovered. It would be desirable, in the case of foreign currency loans, for taxes and other non-registerable claims such as wages to be subordinated in order to provide the lender with a clear first security interest. Most importantly, the law should enable the secured lender to seize the collateral immediately upon default and to sell and collect the collateral promptly upon application to the court. (See "The Problem of Timing" below).

2. **Foreign Exchange Controls and Export Licenses** The second structural obstacle to the financing of coffee stocks and hedging against adverse price movements lies in the regulations relating to foreign exchange and issuance of export licenses.

a. **Permissible Hedging Operations** Few coffee exporting countries today expressly authorise the purchase of foreign exchange for purposes of meeting deposit and variation margin calls, or for purchasing puts and calls or for settling puts and calls which have been sold by an exporter. Colombia is one of the few coffee-exporting countries which authorise the establishment of off-shore hedging accounts and the release of foreign currency by the central bank for this express purpose, within limitations designed to curtail tax fraud and capital flight. If hedging is not expressly permitted under central bank regulations, indirect hedging strategies which, for example, shift the burden to the purchaser, are liable to run afoul of the official policies and result in fines and the cancellation of export licenses if discovered. The better approach is for the central bank to acknowledge the legitimacy of hedging operations related to physical coffee sales and to adopt regulations which control these operations to avoid abuse and speculation.

b. **Restriction on Export License Issuance** Many countries do not permit the issuance of export licenses unless the physical coffee exists, the export price is fixed, and a letter of credit is issued and advised to the central bank. When issued, export licenses often expire if not used by a certain date, and may be issued solely in the name of a local exporter and are either non-transferrable or, if transferable, may be transferred or assigned only to other local producers or exporters. Each of these seemingly reasonable limitations has an adverse impact on the availability of stock financing and hedging credit.

i) **Physical Existence of the Commodities** While predictions can be made concerning the size of a crop and the ability of a producer to deliver physical coffee based upon past performance, no lender or broker wishes to speculate on the willingness of the government to grant an export license someday in the future. If the government is willing to grant the license at the beginning of the growing season, when pre-export credits are needed, or upon the execution of a long term supply agreement, banks and commodity brokers can rest much easier in granting stock loans or credit lines for hedging purposes.

ii) **Price-Fixing of Coffee** Most coffee traders would prefer to fix the price of coffee to coincide with the anticipated delivery date to buyers and roasters, often many months after the purchase agreement with the exporter has been signed. If local regulations require that the export value be fixed at the time the license is issued, the exporter has the choice of either fixing the cash price well before the preferred and logical quotational period, or of waiting for a date near to the delivery period to obtain the license. If the decision is made to delay the issuance of the license until delivery, the exporter, bank and buyer are left with the possibility that for some reason the license might not be issued, which casts a shadow of uncertainty and with it a "risk premium" which must be paid by the exporter. If, on the other hand, the cash price is fixed earlier in order to secure a license, the exporter risks a possible rise in market prices which could not only lead to a market loss but, in an extreme case, result in a cancellation of the export license.

These uncertainties could be avoided, and both export financing and hedging credits made more easily available at lower cost, if local regulations provide that the export price need not be fixed at the time the license is issued but instead may be based upon a quotational period nearer to the consumption period and a price reflecting the relevant commodity exchange price during that period.

iii) **Letter of Credit Issuance** Often export license regulations require the exporter to have obtained a letter of credit covering the purchase price at the time the license is issued. If, as is desirable, the coffee supply contract is a long-term contract for deliveries well into the future, in order to obtain the export license promptly following signature a letter of credit would be required long before there is any practical necessity. Letters of credit will not only tie up the trader's credit lines, but normally attract a quarterly commitment fee which can be recovered only by increasing the differential between the relevant market price and the price paid to the exporter. Moreover, for many smaller traders, letters of credit may only be available on a back-to-back basis, that is, once the buyer or roaster has issued a letter of credit in favour of the trader, which is not likely to happen more than 30 to 60 days prior to the actual delivery date. These unnecessary financing expenses and missed marketing opportunities are avoidable if the export license regulations provide that licenses may be issued subject to the later posting of an acceptable letter of credit anytime prior to the date of actual export.

iv) **Extension of Export Licenses** Lenders and providers of hedging credits are always concerned about the possibility that due to a shortage of stocks, transport delays or other factors beyond the control of the exporter, the export license might expire prior to the shipment of the entire amount of coffee required to repay the advance or cover the forward sale. The possibility of delay is always present and will remain a concern, however the severity of the risk would be reduced if export licenses relied upon by foreign lenders, traders and brokers are automatically extendable or renewable if the requisite amount of coffee is not shipped within the period of the license. This need for renewable licenses is particularly strong for crop loans and long-term supply agreements where the physical coffee does not exist at the time the advance is made.

v) **Transferability of Export Licenses** In most coffee exporting countries export licenses may only be issued to registered and approved local companies engaged in the coffee trade, and may not be issued to foreign companies or to companies not engaged in coffee exporting. This creates severe difficulties for financing banks, because there is the possibility that in the event of the insolvency of the exporter, the lender will not be able to take control of the license and export the coffee in the lender's name. In these circumstances, the lender may be left with the sole remedy of selling the coffee in the local market for local currency. This is not an attractive option for the lender and contributes substantially to the risk premium paid, particularly by smaller exporters. Export license regulations should provide that a license is transferable to a financing institution or a foreign trading company upon simple notice to the licensing authorities.

3. **Political Risk Insurance** Many if not most pre-export finance credits extended to coffee exporters today are covered by one form or another of so-called political risk insurance issued by underwriters such as Lloyds in London, AIG and CITI in the United States, and Pool d'Assurance des Risques Internationaux et Speciaux in Paris. These polices essentially cover the risk of non-delivery of the coffee or other commodities due to (i) failure of a governmental exporter to ship the coffee or failure of a government guarantor to repay the advance (contract repudiation), or (ii) failure of a local private exporter to deliver the coffee due to a change in the export regulations or other governmental interference (contract frustration), or (iii) inability of a foreign company to ship the coffee due to cancellation of export licenses or confiscation, expropriation, nationalization or deprivation of the coffee (CEND). Many banks will waive country credit ceilings for transactions covered by these policies on the basis that the transaction presents "performance" risk rather than credit risk, and that the bank stands to be reimbursed by a credit-worthy insurance company in the event of non-performance of the commercial agreement. Similarly, traders who purchase political risk insurance are more likely to find banks willing to finance the transaction on a non-recourse or limited-recourse basis.

Private market political risk insurance policies are taken out by the overseas trading company or lender, but are normally not disclosed to the exporter because of a strict confidentiality covenant in the policy. Despite the somewhat invisible nature of this coverage insofar as the exporter and government are concerned, the availability, terms and cost of these policies are an important factor in determining the amount and cost of coffee export financing. Coffee exporters and central bankers should therefore be familiar with the operation of these policies in order to assist credit providers to obtain the best possible coverage at the lowest possible premiums. The major areas in which exporters and governments can influence the availability of insurance coverage are as follows:

a. **Clarity of Local Laws Relating to Exports and Export Financing** All political risk policies contain a strict warranty requiring the insured trading company or lender to comply with all local laws and regulations. Normally, the insured will obtain an opinion from a local lawyer that all necessary approvals and registrations have been obtained and made, however if the law is unclear and it later appears that the transaction has not been validly authorised, the policy may be void and there is little practical recourse against the local lawyer. A clear and comprehensive set of regulations relating to foreign pre-export financing and hedging credits will provide far stronger coverage under these policies as well as lower insurance premiums. The lack of clear rules relating to pre-export financing transactions, or frequent changes in the rules by the exporting country, can result in complete unavailability of coverage, or very high premiums, and can limit the reliability of the coverage to the insured.

Also, some countries have adopted laws which cannot be complied with from a commercial standpoint and in order for commerce to continue these laws are avoided through informal means. For example, in countries which maintain minimum export prices which are higher than world market prices, exporters will often load additional commodities or commodities of a higher grade than the amount or grade shown on the export license. Although such practices might be widely followed in the trade and may even be ignored by officials, any failure to comply with export regulations would void a political risk policy and therefore render the policy useless to a lender. In order for political risk insurance to be available as an effective financing tool, coffee exporting countries must seek to eliminate regulations which cannot be complied with in practice.

b. **Clarity of Laws Relating to Title and Security** Political risk policies normally exclude claims if the loss is a result of the lender or trader having failed to obtain clear title to the commodities or to obtain an effective security interest. The importance of having clear laws relating to title, security interests and the rights of secured creditors in bankruptcy was discussed in the first section of this report, and need not be repeated here, save to say that a local lawyer's opinion is no substitute for clear, comprehensive and reasonable legislation. Disputes relating to title to goods and security interests are nearly always resolved under local law and often by local courts, and if that law is vague a political risk insurance policy might be of very limited value.

c. **Permit Foreign Companies to take Title and hold Export Licenses** By far the least expensive form of political risk coverage and the form having the greatest underwriting capacity is the CEN policy covering confiscation risks and denial of export licenses. This coverage is normally only effective if the insured (usually the foreign trading company but sometimes a lender) has good title to the coffee and holds an export license in its own name. By taking one small step, which is to adopt laws and foreign exchange regulations which permit a foreign buyer to take title to coffee even if only a portion of the eventual purchase price has been paid, and which allow the issuance of an export license to the buyer at the time title is taken (subject to price fixing and payment at the time of export) the exporting country and its lenders can enjoy the finest rates and terms of coverage available for that country in the insurance market.

d. **Early Issuance of Export Licenses** Most political risk policies expressly cover losses resulting from non-delivery of coffee due to cancellation of export licenses, which is always a greater risk if the sale price is fixed in advance and the market price goes up prior to shipment. However, many policy wordings require the license to have been granted or committed at the time the policy is entered into, and will not cover losses if it is later determined that the exporter or trader did not have the right to receive a license at the time the policy was taken out. As is the case with questions of title, if the law relating to export licenses is not clear, or if the export license can be lost due to, for example, the insolvency of the exporter, the political risk policy will be of little value. Conversely, the value of these policies to the lender, and ultimately to the exporting country, is greatest if the export license can be granted at the time the export contract is entered into and can be either issued or assigned to the foreign trading company or lender.

e. **Continuation of Government Guarantees for Newly Privatised Exporters** In some cases transactions have been entered into with government-owned exporters which become privatised before the contract has been fully performed or the loan has been repaid. If such a transaction were insured under the usual form of contract repudiation policy, all coverage could be lost once the government ceases to own and control the exporter. To avoid this inequitable result and increase the effectiveness of political risk insurance in attracting loan capital to the country, governments should adopt a formal policy of extending performance guarantees to the lenders and trading partners of newly privatized exporters until all outstanding commitments have been satisfied. In this way the coverage granted under the political risk policy will be preserved following the privatization. Once the original loans are repaid, subsequent financing could be carried on under the contract frustration or CEND policy formats.

f. **Permissible Termination of Long-Term Credits if Insurance is not Extended** One of the limitations on the use of private market insurance coverage is its relatively short maximum policy term, which is thirty-six months. The rules governing this type of insurance prohibit an underwriter from committing in advance to renew or extend the coverage period beyond the initial three year term, although at the expiry of each policy year it is usually possible for the underwriter to extend the policy for a further year, such that the maximum of three years of coverage always remains in place. These renewals will be based upon market conditions prevailing at that time.

This means that a lender or trading company entering into a financing commitment of greater than three years would incur the risk that the political risk insurance could expire prior to the expiration of the credit facility. Ordinarily, this problem might be solved by a provision in the loan agreement that the maturity date would be accelerated in the event insurance is not available on acceptable terms. However, as the existence of political risk insurance usually cannot be disclosed to the exporter, such a provision would be impermissible under the terms of the policy. This places both parties in a dilemma and substantially reduces the effectiveness of these policies in arranging longer-term credits.

The problem could be at least partially solved if the exporter were willing to accept a provision in a long-term loan agreement permitting early termination of the facility upon two years' notice. This permits the lender to commit to provide financing for, say, five years, which is two years longer than the initial three year policy period, but to withdraw from the credit over a reasonable period if the insurance underwriters decline to renew for a further year at the end of any policy year. In the event a 3-year policy is not renewed for a further year at the end of the first policy year, the exporter would have at least two years to either pay off the loan or to arrange for refinancing. It is admittedly awkward that this right of early termination in the loan agreement could not be expressly linked to insurance, because insurance must remain undisclosed, and would have to be expressed in terms which would enable the lender to terminate upon two year's notice in its absolute discretion. An exporter, when faced with such a clause in a long commitment extending beyond three years, could infer that the clause is intended to cover non-renewal of a political risk policy, however the lender could not justify the clause on this basis because disclosure is prohibited.

g. **Damage Calculation Clause in Pre-export Finance Agreements** The loss calculation provisions in political risk policies are often somewhat vaguely worded, which can create problems for lenders, coffee traders and commodity brokers when insuring against the risk of non-delivery of commodities. If the sale and financing agreements include a very clear provision concerning the determination of damages, the political risk policy can incorporate the same provision, which will make policy coverage far more transparent and useful as a financing tool. The calculation of loss provision in the pre-export finance agreements with the exporter should provide a clear method of calculation of losses for: (a) non-delivery; (b) delivery of off-specification grade or quality; (c) market loss due to late delivery, including net losses sustained in closing out hedging contracts; (d) increased freight costs incurred in cancelling committed freight and for covering freight for the onward sale; and (e) other out-of-pocket expenses including demurrage and non-refundable deposits and other amounts paid to carriers or their agents, and other amounts paid to providers of goods or services in respect of the coffee to be delivered. If the supply contract is guaranteed by a government agency, the guarantee should specifically incorporate the Calculation of Damages Clause.

h. **Establish Official Contacts with Underwriters in London, Paris and New York** Insurance companies have been called the "invisible bankers," because in modern finance transactions insurance companies are taking an increasingly prominent role both in covering risks and in funding. Nowhere is this more true than in pre-export financing of commodities, where a substantial percentage of the transactions are covered by political risk insurance. Even though the existence of these policies is usually not disclosed to the exporter or to the government of the exporting country, the availability and cost of coverage can have a dramatic effect on the ability of the country to raise bank financing. Just as they do with the major international banks, central bankers, ministers of finance or ministers of foreign trade should establish periodic contacts with the major political risk underwriters to demonstrate good will and an appreciation of the role of political risk insurance in financing of local exporters. Contacts of this type would assist the underwriters greatly in analyzing the risks and increasing the availability of coverage.

4. **Property and Casualty Insurance Regulations** One of the pillars of pre-export financing of commodities is insurance coverage against fire, flood, theft, and losses resulting from strikes, riots, and other civil unrest. Banks and trading companies normally require that the coffee be covered against these risks under policies written in US dollars and that claims are payable directly to the bank or trader outside of the exporting country. In some countries, insurance and exchange control regulations require that all in-country risks be covered by local insurance companies and that claims must be paid in local currency. In order to facilitate pre-export financing of commodities, local insurance and exchange control regulations should permit off-shore insurance of commodities which are being financed by foreign companies.

5. **Familiarity with Standard International Loan Agreements and Collateral Verification and Control Procedures** One of the key issues in negotiating financing facilities for commodity producers is the need for sometimes complex loan documentation and collateral control programs. As

mentioned above, commodity traders in the past have been inclined to provide finance on the basis of the established business relationships with minimal documentation and security. Exporters in coffee producing countries may not therefore be accustomed to the demands of bankers for comprehensive documentation, verification of collateral and on-going controls, demand for financial statements, and other procedures which North American and European commodity producers now accept as customary. Coffee producers and governments which are willing to cooperate with financiers in developing appropriate documentation and controls will be much more successful than those which insist on the minimal documentation acceptable to trading companies. Indeed, an effective strategy may be to anticipate a lender's needs by preparing a comprehensive loan and security package in advance which can be offered to several banks on a competitive basis for the best rates and terms.

6. **Other Forms of Collateral for Stock Financing and Hedge Line Credits** In addition to growing crops and physical stocks awaiting shipment, exporters may have other forms of collateral which would be acceptable to a bank providing stock or hedge financing. Examples of acceptable collateral would be coffee stocks held in Rotterdam warehouses, in-the-money options held by the exporter, deferred payment letters of credit, trade bills and trade receivables for coffee previously delivered, and cash deposits held offshore. Taken together, such assets could provide sufficient security to obtain a substantial credit line or to increase the amount of advances available for financing and hedging coffee exports.

7. **The Problem of Timing** One of the principal obstacles in financing commodity producers, be it stock financing or hedging lines, is the problem of timing. Unless and until local commodity exchanges are developed in commodity producing countries, forward and futures coffee prices will always be fixed by reference to a distant terminal market and a remote delivery period. Commodity traders enter into contracts which require goods to be delivered to the consumer at a distant location within a certain period, and if the export transaction is Price to be Fixed, the price paid to the producer will be fixed on the basis of the market most appropriate to that location and within the agreed delivery period. The difficulty for the exporter, lender and the trader alike is that in many countries inland transport and port congestion can make it extremely difficult to forecast the loading and discharge dates well in advance of delivery. Unless these dates are reasonably certain, hedging the physical contract can actually increase rather than mitigate the risk.

The trading company can seek to offset this risk by building in a "risk premium," however this deprives the exporter of precious foreign exchange, and the stock financier can likewise margin its advances, similarly depriving the exporter of needed working capital. Moreover, in the event of non-delivery or severely delayed delivery the provider of the hedging line can be left with financing a futures position with no physical position to offset it, i.e., pure speculation, which as a matter of policy would not be acceptable to most brokerage houses.

Unlike many of the other obstacles discussed above, which are mainly a matter of public and legislative policies, there is in many developing countries no easy solution to the problem of unpredictable timing of deliveries. If the financing were available, the exporter could cover the contract with coffee bought in the terminal market, or, similarly if financing were available, supply the coffee from contingency stocks held in Rotterdam or domestic stocks borrowed from another producer country. It is clear that in most countries government support will be necessary to give needed priority to value-dated delivery obligations, and until such procedures are in place hedging will be necessarily confined to commodities which are at or very close to port warehouses, or even loaded on board vessel, at the time the hedge is entered into. Timely stock financing for goods in up-country warehouses or of growing crops will in the meantime remain subject to heavy margins to the relevant futures prices, and hedging lines will normally be very limited until the commodities are at or near port.

These are fundamentally logistical problems which have logistical solutions. Particularly for those African coffee exporting countries which have ports, the financial advantages of being able to assure timely delivery of coffee are very substantial, and prompt delivery of value-dated commodities should be given high public policy priority.