Global Commodity Trade Finance Research Report 2021

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Foreword

I am delighted to present to you the 2021 edition of TXF's Global Commodity Trade Finance Research Report. The report is unique in that the survey section is completely impartial with the results generated from the views of companies accessing financing from practitioners in the commodity finance sector.

We would like to thank the 186 respondents that provided input for the survey and all the other industry specialists that helped with qualitative insights.

In terms of the overall commodity market, thankfully 2021 has not had the major disruptions of the type that took place last year. Nevertheless, this year we have still been through a prolonged period of volatility – much of which has been driven by supply and demand, higher commodity pricing as well as significant disruption to supply chains.

Much of the trader sector thrives on parts of this volatility and the surge in prices across a raft of commodities could see some commodity traders generate significant profits again this year. As I write this Brent crude oil is trading at $83 per barrel with a forecast for this high price to be maintained through the winter. Natural gas and hard coking coal are currently both at record highs.

These price hikes are certainly not confined to energy products. Rare earths, minerals required in the renewables sector such as lithium, and certain base metals – such as molybdenum, tin, bauxite, aluminium, cobalt and tungsten have all seen significant price hikes through the course of this year so far.

On the softs front, the price of many food products has surged as of September as harvest issues mainly related to weather and the rising demand for vegetable oils, sugar and cereals influence the market. And for sugar, the market has also been impacted by the disruption of the container shipping sector – as the majority of sugar is now moved in containers.

The seemingly ever-increasing disruptions to supply chains are expected to continue to influence both the price and delivery of commodities whether handled via containers or by bulk carriers. At the end of September, the Baltic Dry Index passed 5,000 points for the first time since 2007/8 – making it much more expensive to ship dry bulk commodities.

The increased demand for commodities and the price hikes theoretically means more demand for finance. However, the commercial bank sector remains risk averse largely because so many banks faced substantial hits last year. As such, while the large traders rarely have problems raising finance, the smaller traders and producers are encountering many difficulties. This does present opportunities for more non-bank financing, but this will come at an increased price.

Commodity finance is a niche business, but we at TXF have always felt that there is an opportunity for the product to play a more central role with a larger range of institutions, policy makers and the real economy in general.

With its independent position within the market, TXF continues to hone the intelligence it can provide, and ensure it is business critical information for our clients and the market in general. Thank you to everyone who spoke to us and took the time to input into the survey this year.

Please do get in touch with your thoughts, and together we can continue this journey, and ensure commodity finance is publicised, scrutinised and analysed to an increasingly high standard in the years to come to help you take your business forward successfully.

We hope you enjoy the report.

Jonathan Bell

Jonathan Bell, editor-in-chief & director, TXF

Introduction

The Global Commodity Trade Finance Research Report 2020 opened with a quote declaring that no one will emerge unscathed from the events of last year. Now approaching the end of 2021, it is fair to say that this was true. This report looks at all the ways in which the market has been impacted over the past 12-18 months, with some changes testing the industry, and others spurring much needed change.

The past year has seen commodities prices soar from all time lockdown lows, with the end of 2020 and the beginning of 2021 even having sparked talks of the next supercycle. Now in Q4 of 2021, there is still no evidence that the market is headed for a supercycle, but there are a multitude of other longer-term issues that have arisen and continue to affect the industry each day.

Necessity is the mother of invention, and the remote nature of a lot of people's jobs over the past 18 months has justly emphasised the importance of advancement of digitalisation in the commodity trade finance industry. A traditionally paper-based and slow-to-digital market was suddenly in need of digital solutions to allow documents to be signed and collected remotely. The first advancements have been made, such as Singapore's implementation of the Electronic Transaction Bill and Sucafina's digital borrowing base, but these are just baby steps in the right direction, with a long way still to go.

The past 18 months have also put a massive emphasis on the need for sustainability and ESG criteria. It is no longer a plus to have an ESG strategy, but is now expected. It is no longer something born from the hope to do good, but is something that banks and corporates will not be able to survive without in 30 years. With the energy transition impending, and the industry looking to decarbonise, the ways in which key players are looking at ESG has begun to evolve beyond the immediate and obvious, and is now so much more than a box ticking exercise.

The commodities industry has also been suffering from reduced liquidity after a number of key banks either pulled back or exited completely last year. And as a result of the cluster of high-profile fraud and default cases that rocked the market in 2020, banks have approached borrowers in 2021 with an increased level of scrutiny. The 'flight to quality' that banks have jumped to has meant that there is less diversity in the loan market, with banks opting to lend more to the biggest players and less to SMEs.

As a result, trader onlending has been prevalent, as many smaller corporates either cannot secure bank funding or cannot afford it. But it isn't just the banks to blame. Bank regulation continues to be weighty and restrictive, and with Basel IV just around the corner, the burden will only get heavier.

Many banks have opted to take their portfolios back to basics, with a return to structure prevailing throughout this year. The outbreak of frauds and defaults have caused banks to value the security from physical collateral, making tighter structures an understandable choice.

Having spoken to the market over the past six months, this report tackles all of these issues and presents the most in-depth primary research available to any individual or organisation active in the commodity trade finance industry. For clarity, this report will use the term commodity trade finance when grouping the different types of financing available to borrowers. Commodity trade finance is an umbrella term that captures structured and transactional (day-to-day) financing.

Questions remain...

Is market sentiment more positive than last year?

How soon will digitalisation be implemented to the extent of being widely adopted?

How are banks and corporates developing in terms of corporate social responsibility (CSR) and transparency?

Is trader onlending always problematic? Are banks or regulations to be held accountable?

Aims and objectives

The aim of this research is to present the latest market trends on commodity trade finance. To meet this aim, the following objectives were undertaken:

- A quantitative survey of banks, brokers, and corporates (traders and producers) to understand the latest trends across the global commodity trade finance industry.
- Qualitative interviews with consenting respondents to explore in greater detail why the quantitative trends might have occurred.
- Inclusion of the latest closed deal market data.

Methodology

The data in this report were collected using a mixed methods design that included a quantitative component - an online survey, and a qualitative component - follow-up phone and email interviews. The data presented in the subsequent sections is an in-depth and detailed exploration of the trends across the global commodities finance markets (the survey), contextualised with detailed insights on why these trends might have occurred (the interviews).

The survey

An online survey platform (SurveyMonkey) was used to collect the quantitative data across commodity trade finance. Specific questions were developed for each industry type with respondents only seeing questions that were relevant to their experiences.

Responses were collected between May 2021 and September 2021. To ensure the overarching aims of this research were met, the survey questions were tailored specifically for the different respondent types. No duplicate data from the same institution were included. If more than one respondent answered from the same institution, the scores were aggregated and then averaged. This approach ensured that every institution was weighted equally.

There are figures throughout the report where the percentages do not total 100%. The reason for this is because they were a 'tick all that apply' style questions. Where applicable, a footnote has been included to aid understanding and interpretation.

A note on sample size

A total of 186 respondents completed the survey. It is important to note that data presented in this report is from a sample that only represents a very small percentage of the respective industries. Moreover, the cross-sectional[1] nature of the data means that it is only representative of the industry at the time the data was collected.

However, these caveats are common across many pieces of research, and while they must

[1] 'Cross sectional' data refers to data collected at a single point in time. Data collected over multiple time periods is known as longitudinal.

be acknowledged, they do not detract from the conclusions drawn from the data. Moreover, because inferential statistical analysis was not conducted on the data, the sample of 186 respondents was large enough to conduct methodologically robust data analysis and, most importantly, for reliable trends and conclusions to be drawn.

Consequently, this report is not making any assumptions or providing definitive conclusions about the entire global commodities market. Instead, the data presented is giving an insight into prevailing sentiments across the different cohorts of respondents on the state of the commodity trade finance industry.

The interviews

To explain the quantitative trends, semi-structured interviews were conducted via phone and email with 10 consenting individuals. Participants were identified through a final question on the survey that asked if they wanted to be involved in a follow-up interview.

The topic guide for each respondent was based on their survey responses, ensuring that the interview remained focused. The interviews were conducted between May and September, 2021. Telephone interviews were audio recorded and email interviews were kept on an encrypted hard drive. To protect the identity of the respondents, all qualitative data has been anonymised throughout this report.

Understanding the interviews

The qualitative quotes used throughout the report are designed to provide additional context and insight to the quantitative trends. The quotes have been analysed against a rigorous framework that promotes transparency and detailed comparison across the interviewees.

This ensures that the quotes are not a collection of anecdotes or isolated views, but instead, an accurate representation across the interviewees. Where there are differing views, these are presented independently within the report.

However, it is important to also state that while the quotes are reflective of the overriding sentiment across all the interviews, they are not intended to be the defining view of the industry on a specific subject.

Closed deal market information

The latest closed deal information from TXF Intelligence is included in this report. TXF Intelligence captures approximately 35% to 40% of all closed deal information in the commodity trade finance industry. Much of the commodity trade finance industry involves club, bilateral or confidential deals that do not get disclosed to any data tool. The TXF Intelligence tool is one of the best in the market to track commodity trade finance, but it is important to recognise that any reference to data is based on an incomplete overview of the market.

Findings

- Background and demographics
- Market sentiment
- Resilience of the sectors
- The digital revolution
- An in-depth analysis of commodity trade finance banks
- A look into the traders' and producers' world

Background and demographics

- A look into which demographics made up the sample size and why
- Changes in the size of respondent’s respective commodity trade finance teams

Background and demographics

A total of 186 respondents took part in the survey, with Figure 1 showing that two thirds represent a corporate intuition (producer or trader). The remainder of respondents were banks (23%) and brokers (11%). The decision to concentrate the majority percentage of responses towards corporates was because they each offer a unique and critical view of the current commodity finance landscape, from an independent perspective.

While it is important to incorporate a range of seniority of respondents' roles, including junior (1%) and mid-level roles (13%), most respondents were either at senior (42%) or global head (44%) level (Figure 2).

Including a range of seniority levels ensures that the data is more complete and inclusive, but it is also vital that the highest concentration of respondents hold decision-making abilities, as these respondents provide a more comprehensive representation of the market.

The sample had a global reach, with just over two-thirds headquartered in Europe (67%), representative of Europe being widely recognised as the global hub of commodity finance (Figure 3). The remainder of respondents were headquartered in Asia-Pacific (16%), North America (8%), the Middle East (6%), Africa (2%), and Central and South America (1%).

Demographics of the respondents

Figure 1: Type of organisation

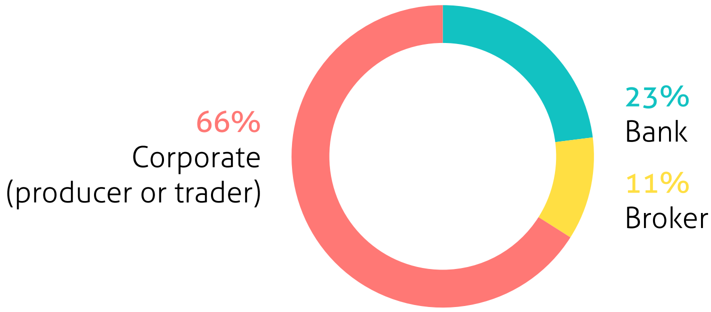


Figure 2: Seniority of respondents' role

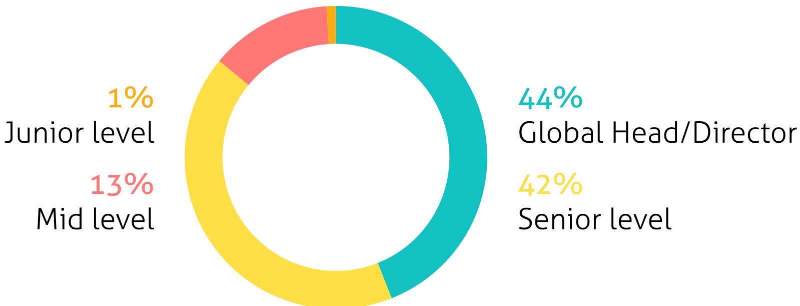
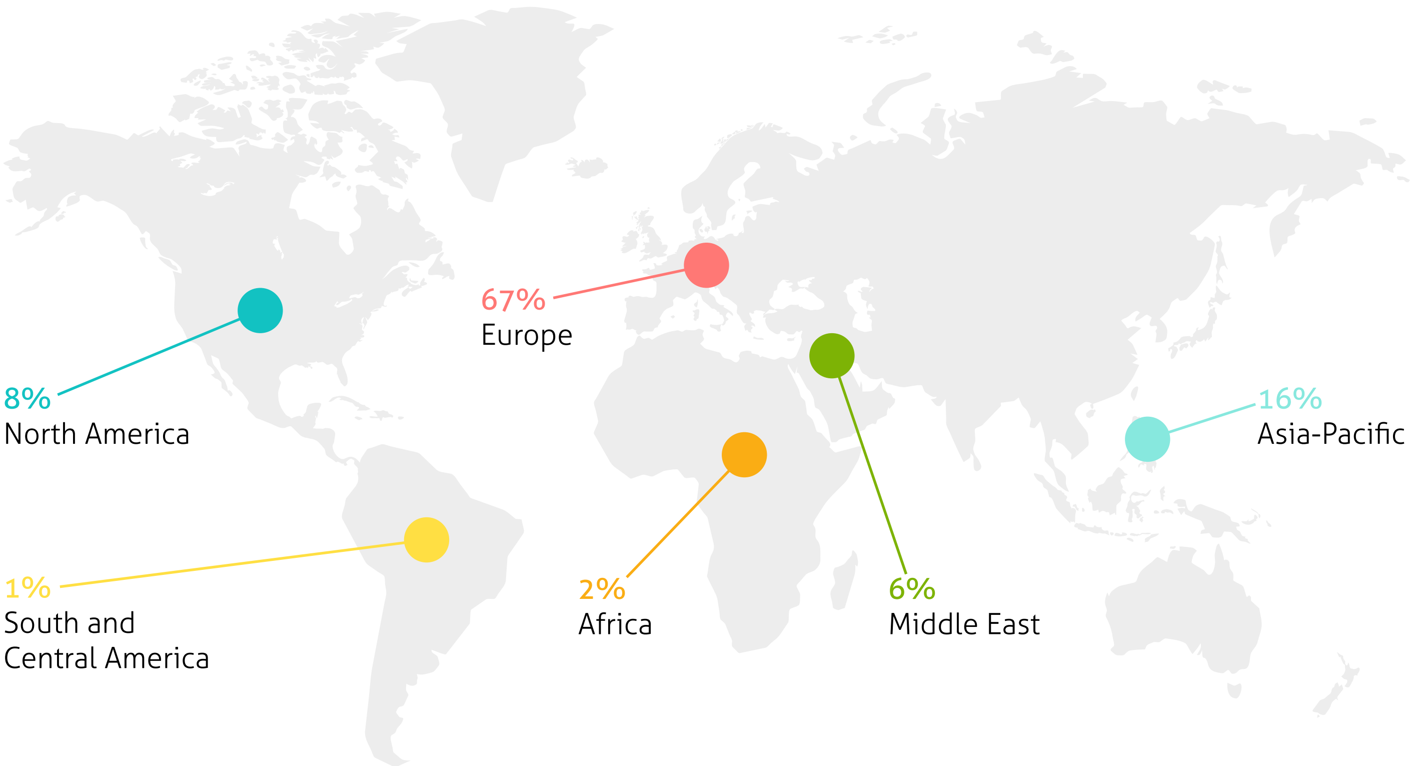


Figure 3. Location of company headquarters



Illustrative of the fact that the commodities industry is a global business, 90% of the sample reported their organisations as having an international geographic footprint, which was specified as operating across all continents (Figure 4). Regional organisations made up 9% of the sample, and just 1% reported that their organisations only had a local geographic footprint.

Almost three quarters of respondents reported the commodity trade finance teams within their respective organisations to be small, at up to 250 staff members, with only 9% reporting medium commodity trade finance teams (Figure 5). This large divide in favour of small commodity trade finance teams could be explained by the subjectivity of how many people make up a 'small' team; the greater end of a 250 people range could also be considered medium, particularly as this is referring to the commodity trade finance team alone, rather than the entire organisation. Large teams made up 18% of the sample, which are likely accounted for by the corporate giants and large central banks.

Figure 4: Geographic footprint of respondents' organisations

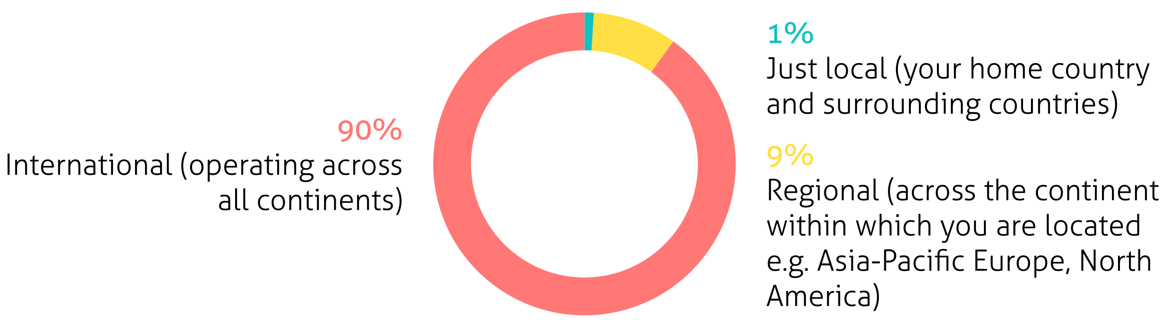
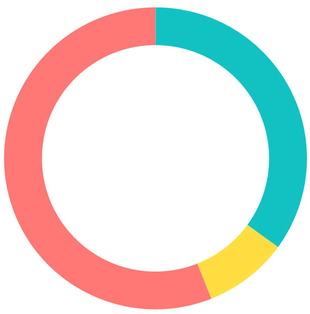


Figure 5. Size of the commodity trade finance teams

According to Figure 6, 35% of respondents reported a year-on-year increase in the number of staff who work in commodity trade finance within their organisations, while 56% says it has stayed the same. Only 9% reported a decrease on last year, which is a positive sentiment for the industry.

It is too simplistic to assume that just because the commodities industry has had a less turbulent 12 months compared to the previous 12 months, it necessarily equates to being a more active one. The TXF H1 data report shows that deal volume is down a massive 50% year-on-year. Evidently, both the direct and indirect consequences of the pandemic have meant that the market is still suffering a year on, but it is encouraging to see that despite some commercial banks having exited or cut back last year, only a small percentage of respondents have reported a decrease in staff in their organisations, with over a third reporting an increase.

Figure 6: Change in the number of staff who work in commodity trade finance



Market Sentiment

• Find out what banks', brokers' and corporates' current sentiment towards the market is, internally and towards the wider market

Market sentiment

Figure 7 shows that there are some notable differences in sentiment between banks, brokers, and corporates. Double the percentage of brokers (60%) reported feeling uncertain in comparison to banks (30%), with corporates (52%) echoing a similar sentiment to brokers.

This inconsistency between banks and corporates could be due to the 'flight to quality' that has ascended on the commodity trade finance industry. As banks have scaled back their lending capacities and become even more selective in favour of mainly the largest and most reliable borrowers, the power is effectively in their hands, which explains why they might be feeling less uncertain than other industry figures.

"Commodity prices are high, which brings certain risks, but nothing is entirely without risk and when compared to 12 months ago, it's a much better situation", says a banker in Europe.

Similarly, 45% of banks reported feeling positive, which is more than three times the percentage of brokers (13%), and more than double the percentage of corporates (22%). Although the bank percentage was much higher than the other industry participants, it still represents a minority of the sample, showing that overall, the sentiment is not positive.

As one European trader puts it: *"The negative elements include ever falling margins and tougher competition. Margins were up substantially throughout 2020 but now the big traders are awash with money, a lot of consolidation has taken place, and inflation is creeping on everyone's heels. You can get commitment in the morning, double digit price rise in one day and refusal to sell in the afternoon. Also, there is much tougher scrutiny in terms of markets and ESG. This slows down processes and creates insecurity."*

While there are not many other significant differences between sentiments, brokers were the only category with none of the sample reporting healthy and proactive sentiment.

"The situation is easier than it was a few months ago. The pandemic made underwriters extremely cautious with regards to what they would cover, but appetite is returning now, and we are getting more interest from insurers. Although the CPRI market is still complicated, the landscape has improved", says a broker based in Europe.

Overall, the data suggests that banks feel as though they are in a more comfortable position compared to corporates and brokers, with brokers feeling as though they are in the least comfortable position. The sentiment that was echoed by all participating groups was that although industry conditions are still tough, there has been an improvement since last year.

Figure 7. Sentiment of the commodity trade finance industry

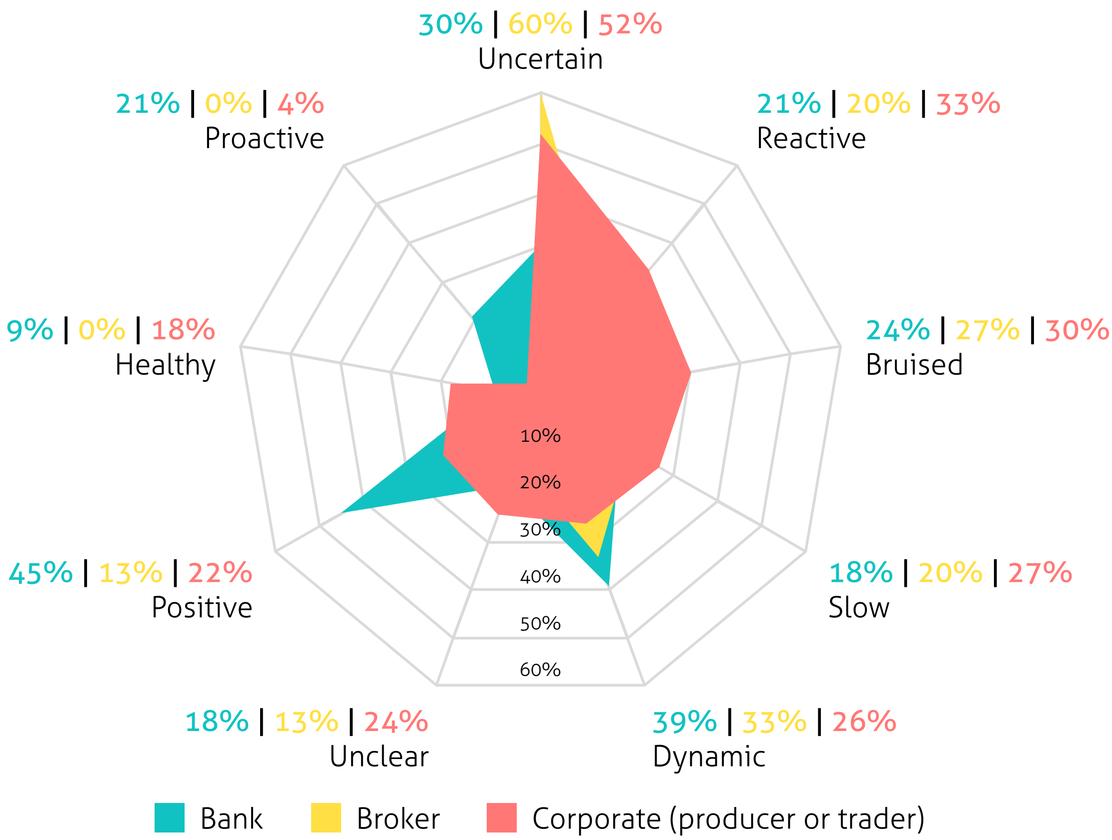


Figure 8: Sentiment on the current state of respondents' organisation

	Bank	Broker	Corporate (producer or trader)
We are in a healthy and profitable position as we move forward	79%	80%	85%
Unclear as we are still assessing the damage caused by the fallout of 2020	6%	7%	4%
I am not sure we will survive much longer in the same manner as before	0%	0%	0%
We have survived and now looking to rebuild	15%	13%	11%

Colour scale: 100%, 75%, 50%, 25%, 0%

Focusing on how the sample view their own organisations, rather than the wider commodity trade finance market, the overall sentiment is much more positive. There was minimal difference between banks (79%), brokers (80%), and corporates (85%), the vast majority of which all reported feeling as though they are in a healthy and profitable position moving forward (Figure 8).

A very minimal percentage of banks, brokers, and corporates (6%, 7%, and 4% respectively) reported that they felt their position was unclear as they are still assessing the damage caused by the fallout of 2020, and encouragingly, not one respondent across all three areas reported that they are not sure the company will survive much longer in the same manner as before. Again, similar across the three areas, 15% of banks, 13% of brokers, and 11% of corporates reported that they have survived and are now looking to rebuild.

It is interesting that a considerably more positive sentiment is shared internally, rather than when considering the commodity trade finance industry in general. If such a large majority of the sample all believe that their respective organisations are in a healthy and profitable position, perhaps the market is not in such a dire position as Figure 7 implies. After all, respondents should be able to give a more accurate representation of their own companies compared to the wider market, especially as almost all of the sample are at decision-making level.

Resilience of the sectors

- Which sectors are showing the most and least resilience and why
- Greatest threats to supply chains

Resilience of the sectors

Figure 9 shows that the agri/softs sector was considered the most resilient, with just over half of respondents (56%) believing it to be resilient, and only 8% considering it not resilient. This could be on the basis that demand for agri/softs is less likely to be affected by unpredictable events, as there will always be an essential demand for food products. During the bout of global lockdowns in H1 this year, agri/softs demand merely shifted from restaurants and cafes to supermarkets and markets, rather than demising like other sectors. But while the sector faces less volatility in terms of demand, it is far more likely to be hit by adverse and severe weather conditions. And even though the world will always need to be fed, food demands are changing will change further – such as the rise in demand for plant-based milk which affects the soya, nut, and dairy sectors.

There is not much difference between the resilience of the energy/chemicals/petrochemicals sector and the metals and mining sector, with 34% and 39% considering them resilient, and 17% and 15% considering them not resilient, respectively. These two sectors could be considered less resilient than the agri/softs sector as they both experienced a drop in demand during lockdown. Another reason that could explain these data is that these two sectors are considered more of a threat in terms of emissions and ESG, and with the energy transition just around the corner, some tangible changes will need to be made for these sectors to have a solid future.

Although metals prices soared this year, with copper having reached a ten year high off the back of an increased demand from electric vehicles and the promise of a green industrial revolution, there has been some concern over a potential supply squeeze, because it can take five to ten years to bring new supply online. Due to this, the sector could be seen as less resilient despite the high prices. Another reason is that despite the metals/mining sector being key to the energy transition and green industrial revolution, the mining methods raise a multitude of questions around ESG, as it is often associated with environmentally unsound practices, unsafe working conditions, and child labour.

Figure 9. Resilience of the sectors

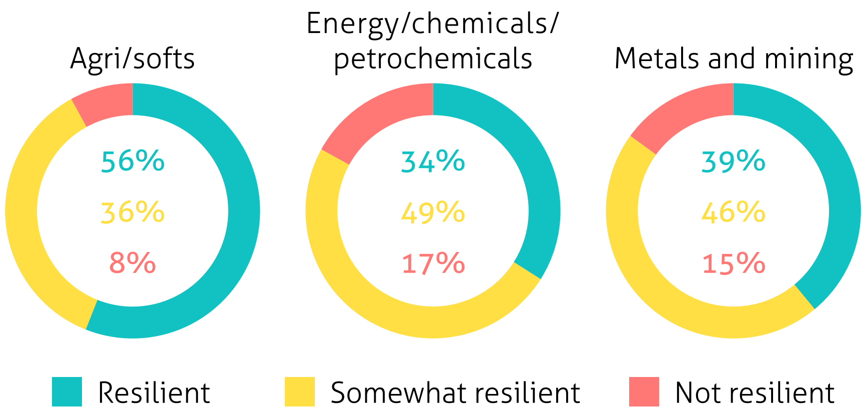


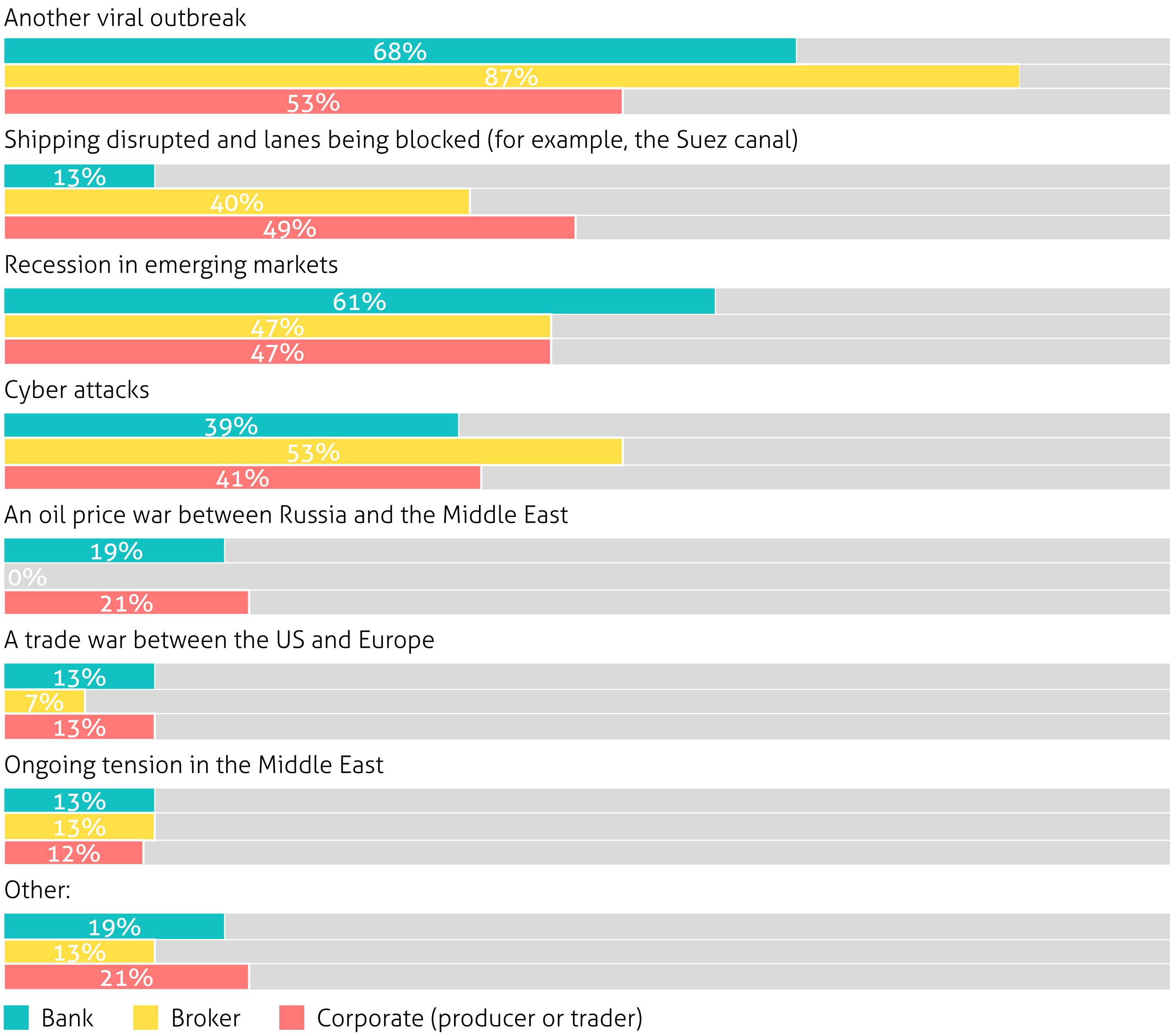
Figure 10 shows that another viral outbreak is considered the greatest threat to supply chains by banks (68%), brokers (87%), and corporates 53%). Before the Covid-19 pandemic, this would likely have not even been considered a big threat, let alone the greatest.

This result could be representative of how severe of an impact the Covid-19 pandemic had on the commodity trade finance industry, as the industry now considers a similar (but unlikely and hypothetical) scenario to be the greatest threat to supply chains. It could also be due to the likelier risk of another Covid-19 strain causing an outbreak.

Although for some people, it may feel as if the world is recovering from the pandemic, another Covid-19 strain could be considered a very real threat to the commodity trade finance industry because many supply chains are located in developing countries, in which vaccinations have not been widely implemented, healthcare services are still overwhelmed, and the knock-on effects of the pandemic are still prevalent.

On average, recession in emerging markets was considered the second greatest threat across all three respondent types, with 61% of banks, 47% of brokers, and 47% of corporates in agreement. Again, reiterating the point made previously – many commodities supply chains are situated in emerging markets, and so if these areas experience serious economic difficulty, it is likely to present significant threat towards commodity trade finance supply chains.

Figure 10. Greatest threats to supply chains



The digital revolution

- How large, medium, and small organisations are feeling about adopting digitalisation
- The barriers between digitalisation becoming a norm
- The Electronic Transaction Bill and what this means for the progression of digitalisation

Digitalisation

Figure 11 shows that more medium (56%) and large organisations (44%) reported that they have always recognised the fundamental importance of digitalisation in commodity trade finance than small organisations (38%). However, these data suggest that despite this, small organisations are still getting on board with digitalisation, with a higher percentage (37%) having reported that they are starting to see the benefits of greater digitalisation in commodity trade finance, compared with medium (31%) and large (28%) organisations. The difference in percentages across the sample for both these areas are small, so these data do not illustrate a substantial difference in attitude between organisation sizes.

More significantly, hardly any of the sample reported that they do not see the need for the commodity trade finance industry to be digitalised at all, with only 2% of small organisations, 4% of large organisations, and zero medium organisations sharing this view – showing that an overwhelming majority of respondents are in support of digitalisation of the industry in some respect.

Only around a quarter of both small and large organisations believe that a more digitalised commodity trade finance industry is years away from becoming a reality, along with only 13% of medium organisations. Overall, this suggests an optimism that digitalisation will be implemented sooner rather than later. Widely adopted remote working patterns during the pandemic truly highlighted a need for the digital agenda to be developed, as it emphasised the barriers created in an industry that is infamous for being traditional and paper heavy.

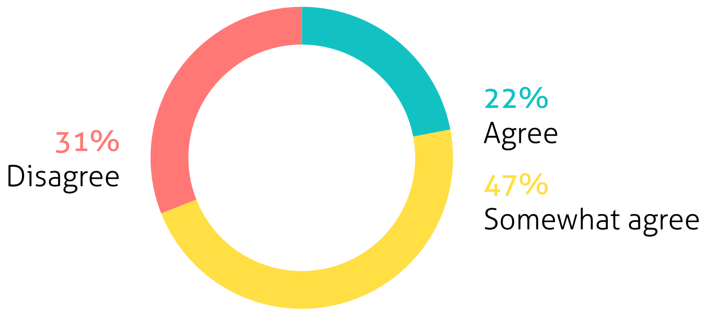
This year, there has been some tangible progress in the digitalisation of the commodity trade finance industry, such as Sucafina's two-year $500 million sustainability-linked deal, which closed in May 2021 and is the world's first digital borrowing base. Komgo, the digital agent on the facility, intends for this structure to be a seedbed for future financings. "We very much think this will be a useful tool for the entire industry in the near future, not just within borrowing bases, but also reserve based lending and other types of asset-based financing", says Kris Van Broekhoven, CFO at Komgo (Howse, May 2021).

Figure 11: Changing views of digitisation

	Small organisations (0 to 250 staff members)	Medium organisations (251 to 999 staff members)	Large organisations (1000 staff members or more)
We have always recognised the fundamental importance of digitalisation in commodity trade finance	38%	56%	44%
We are starting to see the benefits of greater digitalisation in commodity trade finance	37%	31%	28%
We think a more digitalised commodity trade finance industry is years away from becoming a reality	23%	13%	24%
We don't see the need for the commodity trade finance industry to become digitalised at all	2%	0%	4%

Colour scale: 100%, 75%, 50%, 25%, 0%

Figure 12: The risk of transparency detrimentally impacting margins

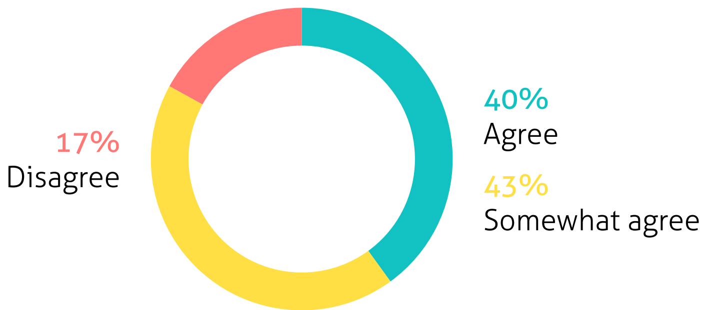


According to Figure 12, two thirds of banks either agree (22%) or somewhat agree (47%) that transparency (or lack thereof) poses the risk of detrimentally affecting margins. In other words, if a company is not transparent in terms of financial disclosures, margins will likely be higher. This is one of the ways in which going public can improve a commodity trader's reputation, as it will not only encourage more ESG conscious investors, but could also result in tighter pricing (FT Lex, 2021).

Figure 13 shows that most respondents either agreed (40%) or somewhat agreed (43%) that too few companies are adopting blockchain for it to become mainstream. This is perhaps unsurprising, as blockchain is not yet a norm in commodity trade finance. For example, Sucafina's digital borrowing base with Komgo (a blockchain trade finance platform) was the first deal in which Komgo featured as digital agent.

"Digitalisation is certainly happening. But it does not necessarily have to be linked to blockchain. Blockchain is just one of many tools in the technology kit that can be used to solve pain points. Customers will only choose blockchain based solutions if these bring meaningful value. As long as that is not the case, these solutions won't scale and blockchain won't become mainstream", says one Europe-based fintech.

Figure 13: Perception on whether too few companies are adopting blockchain for it to become mainstream



When looking at the collective responses of banks, brokers, and corporates, which all answered similarly, cost was considered the biggest barrier when it comes to wider implementation of digital platforms (42.3% on average) (Figure 14). These data could be viewed a positive sentiment in favour of digitalisation, because a more practical, financial barrier is put above doubt in accepting digital platforms, for example not seeing any benefit in it (26.5% on average), or a reluctance internally to change existing processes (6.3% on average).

Figure 14. Barriers to wider implementation of digital platforms

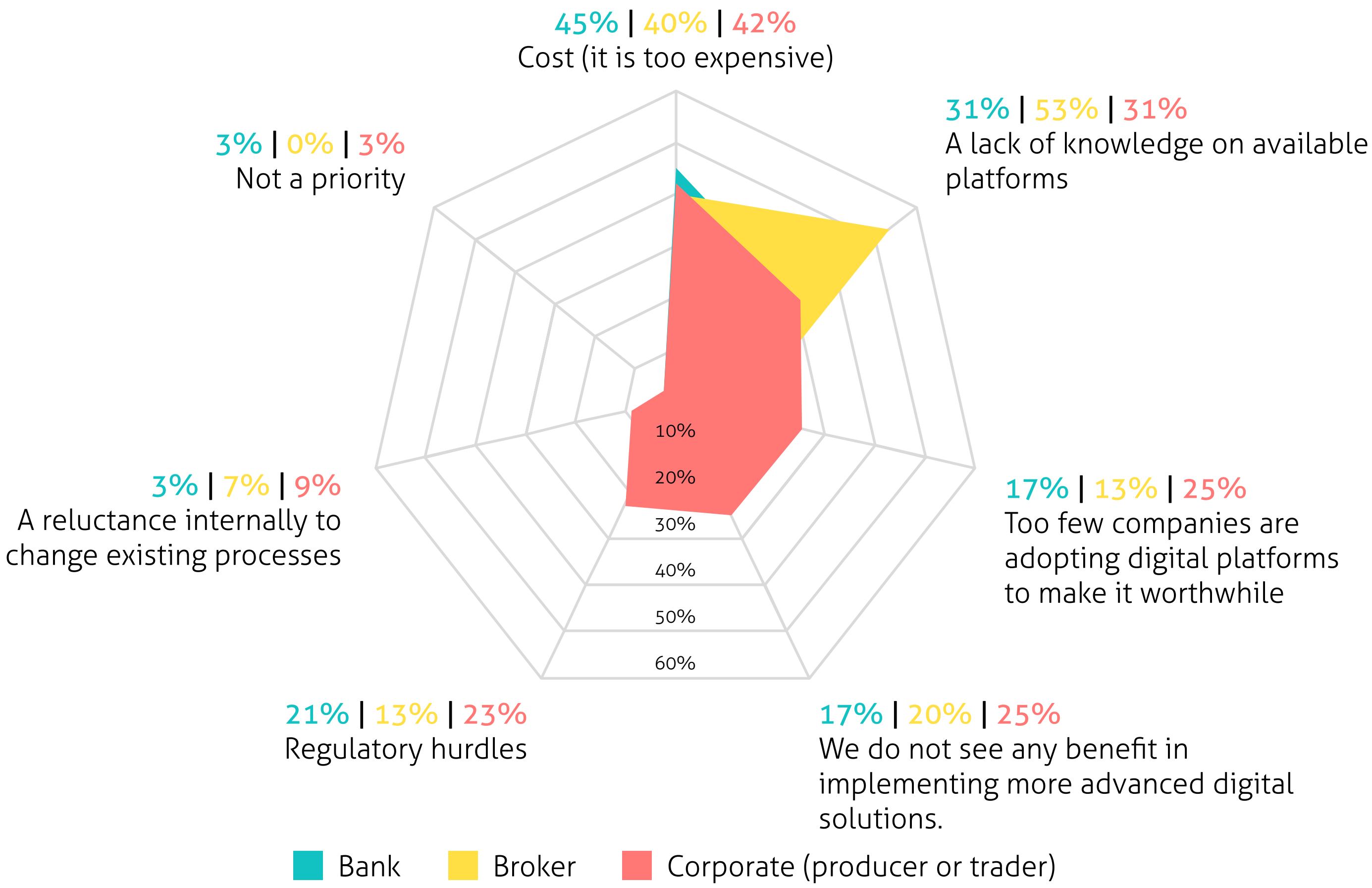


Figure 15: Importance of the amended Electronic Transaction Bill

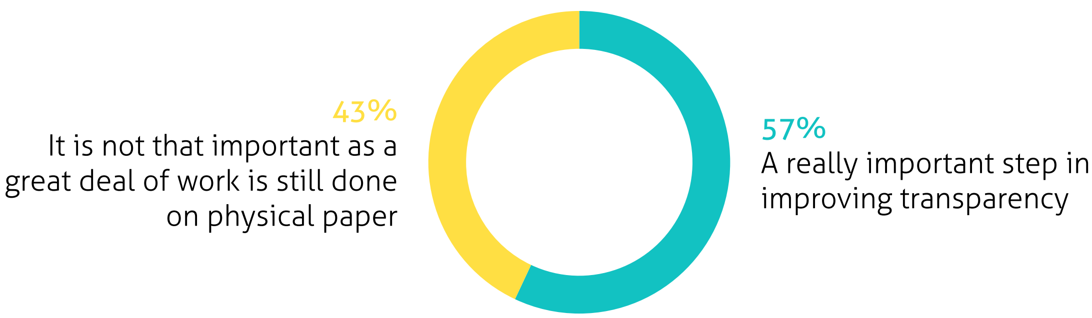


Figure 15 shows that the commodity finance banking industry is relatively divided in terms of the importance of the Electronic Transaction Bill, with just over half (57%) in favour of it being a really important step in improving transparency. Introduced on 4 January, the Singapore government amended the Electronic Transactions Act to create the Electronic Transactions Bill, the primary object of which is to achieve recognition for transferable documents and instruments, such as bills of lading, bills of exchange and promissory notes, represented in electronic form (Abanto and Co., 2021).

Although Figure 15 explores the importance of the bill in relation to transparency, this is not necessarily the criteria which most accurately measures its worth. As one Singapore-based lawyer puts it: *"I don't think increasing transparency was the principal driver for this change. I think that it was a combination of the Covid lockdown, which made the ability to sign paper documents a lot more difficult, and created a strong demand to ensure that electronic signatures and other records would receive legal recognition, and Singapore's desire to be at the forefront of the digital revolution, and to ensure that their laws allowed for this."*

Another lawyer in Singapore argues that although it is not an advancement in transparency, it sows the seeds for progress: *"The legislation itself does not provide greater transparency on its own, but rather the ecosystems built around it shall do so. If set up correctly, the platforms supporting digital trade will issue immutable electronic trade documents that cannot be replicated. All parties to the transaction should have visibility in relation to such documents via the trusted platform(s) used in a trade."*

Although 43% of respondents said that the Electronic Transactions Bill is not that important as a great deal of work is still done on paper, perhaps the most noteworthy thing about this development is that it is only the very start, and is expected to pave the way for future legislation. As the first lawyer puts it: *"In order to see some real progress, particularly with electronic bills of lading, more countries will need to pass laws recognising electronic transferable instruments. Most trade is cross-border and so to make use of electronic bills of lading, the parties to a transaction are likely to want comfort that they will be recognised in all of the jurisdictions relevant to the transaction, of which there may be many. The fact that Singapore has adopted these laws is a positive step and we know that the UK is currently looking at the possibility of adopting these laws too. Hopefully this can now build some momentum and other countries will soon follow suit."*

The second lawyer reiterates this point: *"The amended legislation in Singapore is a very important steppingstone to digitalisation of trade transactions with a Singapore nexus with the end goal of facilitating trade and assisting reduction in fraud. It is by no means the immediate "fix it" solution, in itself, to enable widespread use of digital media for trade to eliminate fraud, however it will set out a legal framework in Singapore to enable digital platforms to provide open networks to support trade (as opposed to the current closed networks) provided those networks are interoperable. A similar amendment to English law is required to make this amendment have more global impact."*

But progress is not linear, especially when measured on a global scale. The second lawyer continues: *"Having global systems that work together is key to the success of digital trade and not all countries will be able to advance digitalisation legislation at the same rate. A similar change to English law is key for this amendment to have global resonance, however paper may still be necessary in the meantime for certain countries."*

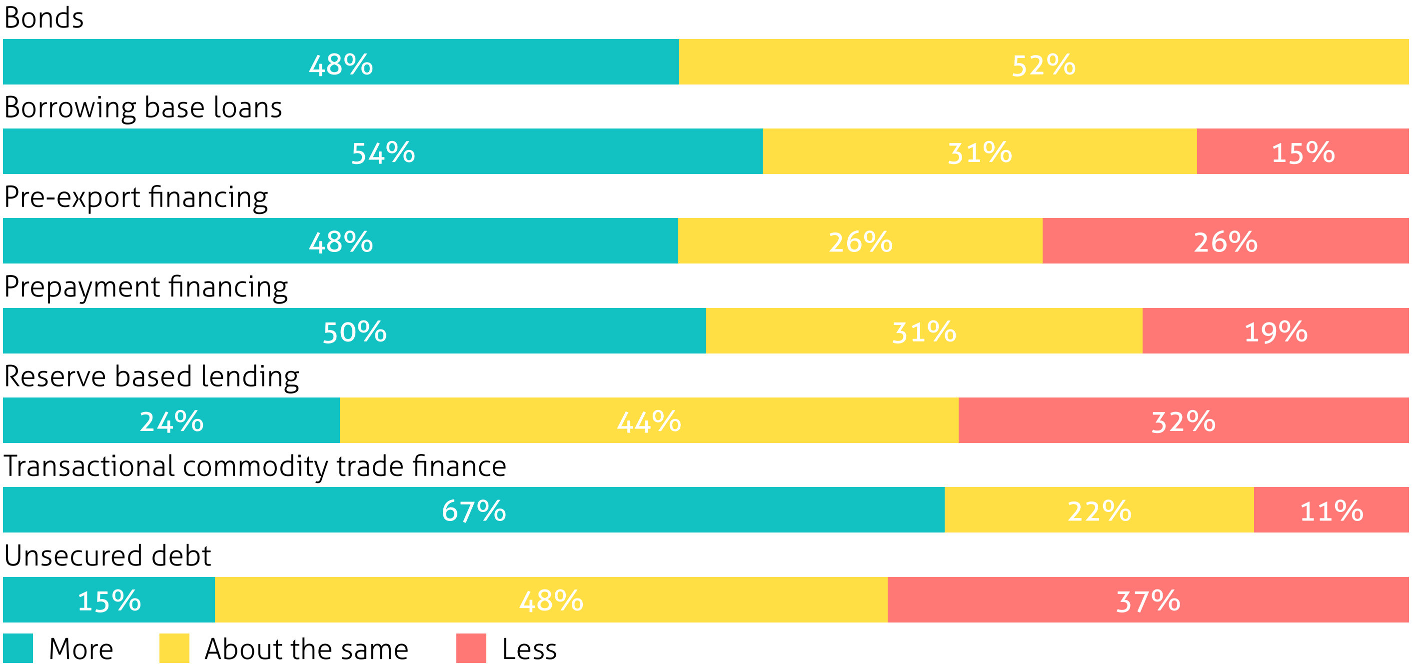
An in-depth analysis of commodity trade finance banks

- Changes in product offering for borrowers
- The biggest concerns over trader onlending
- Banks' views on the health of the market
- Bank commitment to TCFD and CSR

Commodity trade finance banks: In focus

"In the past 18 months, we have stripped our product offering back to basics. We have been careful in loosening structures and have tried to avoid this if we can.", says a banker based in Europe.

Figure 16: Change in products on offer to borrowers



According to Figure 16, the highest percentage of respondents reported more of the following structures: borrowing base loans (54%), pre-export financing (48%), and prepayment financing (50%). This is in line with last year's TXF Global Commodity Trade Finance Industry Report, of which the data predicted that there would be an increase of all three structures.

However, the results of last year's report only indicated that there would be a slight increase, with just 3% more respondents saying that they would use borrowing base loans compared to the last 12 months, 4% more saying they would use reserve based lending over the next 12 months, and 10% more saying the same about pre-payment financing. With around 50% of respondents saying that they have used more of each of these structures in the past 12 months in this year's report, it is clear that the uptick in structure has been much steeper than originally anticipated.

It is likely that this uptick in structure is one of the knock-on effects of the high-profile fraud cases and defaults that shook the commodity finance industry last year. Highly structured facilities tend to be less susceptible to fraud and defaults as they offer tangible security in the form of inventory or invoicing, making them a safer option in the wake of 2020's events (Howse, November 2021).

Figure 17 and 18 show that although the vast majority (78%) of banks offer RCFs to borrowers, they make up less than a quarter of banks' entire portfolio. This could suggest that although RCFs are offered by most banks, borrowers are taking on more corporate (vanilla) financings compared to RCFs. Although structured finance is also a key debt choice in the commodities industry, it tends to be less commonly used compared with revolvers.

Figure 17: Proportion of banks that offer RCFs to borrowers

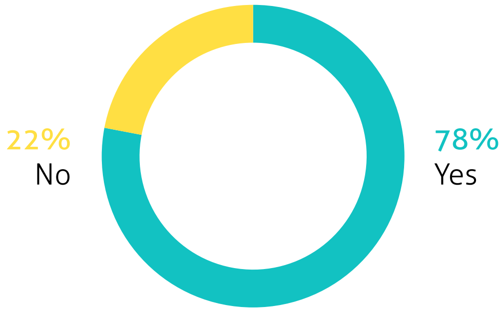


Figure 18: Proportion of RCFs compared to the banks entire portfolio

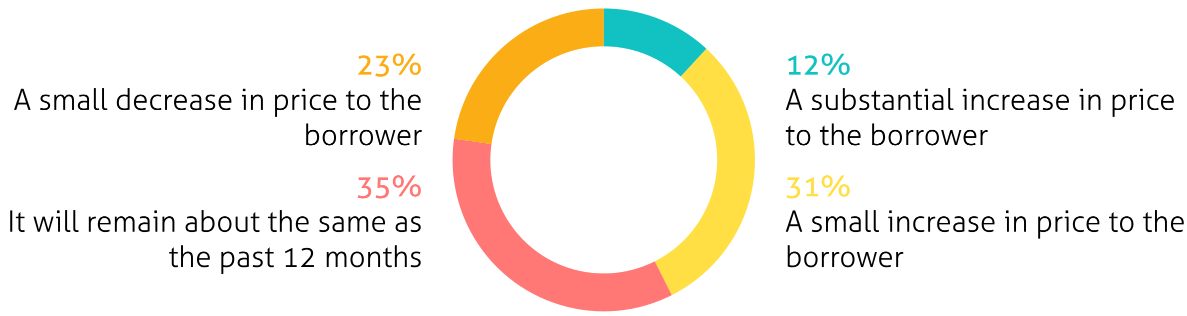
23%

Figure 19 shows that there has been a divide in change in RCF pricing compared to the past 12 months, with the biggest percentage of the sample reporting that price will remain around the same as it has been for the past 12 months. However, 31% said there would be a small increase in price to the borrower, 23% said there would be a small decrease, and 12% said there was a substantial increase in price to the borrower. Overall, these data show that there is quite some variety in RCF pricing throughout the market, but across the board, the highest percentage of respondents (43% altogether) said that there was an increase, whether it was small or substantial.

As previously touched on in this report, the 'flight to quality' that banks are following has ultimately led to an uptick in cost of debt, as banks are steering their portfolio's away from SMEs and towards the biggest traders. Therefore, banks can raise their margins in the knowledge that a select few top borrowers (which now make up an even higher proportion of their debt portfolios) can and will pay more, particularly when it concerns unsecured debt.

According to one European trader, *"I'm not advocating that all banks charge double, but if it applied to everyone, I would be happy to pay it".*

Figure 19: Change in RCCF pricing compared to the past 12 months



Just over half of respondents (54%) anticipated that they plan to lend around the same volume of RCFs, with 20% saying they plan to lend more and 24% saying they plan to lend less (Figure 20). Overall, this does not represent any major changes, as it is standard to have some variety of RCF volume throughout each year.

Figure 20: Anticipated changes in RCF lending over the next 12 months

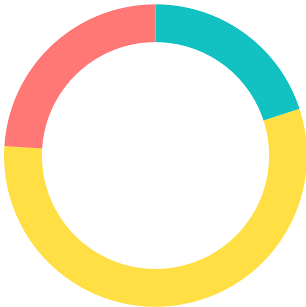


Figure 21 shows that most respondents (69%) are somewhat concerned with traders using RCFs to onlend to smaller borrowers. While 23% were not concerned, 8% reported that they were very concerned over this. It is known that many large commodity traders, which are able to secure large volume revolvers at a cheap price, often onlend a portion of this debt to smaller corporates who are not able to secure bank debt, or cannot afford bank debt. Large commodities corporates also often use these arrangements as an exchange for an offtake contract from a smaller producer, and tend to not admit to doing this as it is unregulated lending.

Trader onlending can be considered positive for the market, as it helps to bridge the funding gap. If banks are not willing to lend to smaller corporates, or the smaller corporates cannot afford bank debt, larger traders who are willing to shoulder the risk can onlend some of their own debt portfolio for a slight profit, meaning that smaller companies can secure debt, big traders make a profit, and banks do not onboard clients that they consider too risky – a win-win-win.

But it is not that simple, and as Figure 2 shows, there are a number of reasons why trader onlending is a concern to banks. The most popular concern, with 35% of respondents in agreement, was that there is no built-in risk in onlending. Arguably, the reason that this concerns banks is that if a large number of smaller corporates defaulted on secondary loans, then there is a risk that the initial borrower which onlent its debt portfolio in the first place could default its repayments back to the bank for the original loan. However, this is unlikely to happen as the size of organisation which choose to onlend have massive portfolios and can afford to shoulder some of the fall out, if there was any.

"I think banks should "only" be concerned if the on-lending is to counterparts who are not part of the trader's natural supply chain. For example, if a metal trader is lending to grain producers, that would be concerning, but if a metal trader is giving advances or credit to those it buys from, then that is very reasonable.", says an alternative fund manager.

Another reason for concern, with 23% of the sample behind it, was that it causes banks to lose out on business. This is an interesting argument, because although onlending does mean that business is going elsewhere, it is arguably going elsewhere because it was not available from banks in the first place.

"It is rather opaque activity. As a banker, you are actually part of the "problem", if your management is saying that you can only lend to large companies, and these large companies mainly borrow via un-structured facilities (e.g. bonds, RCFs, general purpose term loans), then you are "creating" or at least fuelling this shadow-banking "problem", which has repercussions when it comes to having transparency of supply chains, and being able to understand end to end risk (which is what trade finance is all about).", the alternative fund manager continues.

However, increasing bank regulation does also come into play here. The progressively tightening regulatory standards – soon to advance again with the introduction of Basel IV in January 2023 – cause a certain amount of restriction towards what kinds of deals banks can lend on. It is not necessarily through choice that banks do not lend to as many SMEs, as regulation and compliance makes it harder to lend to smaller players. While in some cases, it could be seen as if trader onlending is helping to plug the funding gap towards which banks are unwilling to lend, on the other side of the coin, in some cases banks are restricted to the point of being unable to lend to SMEs, so it could be seen as unfair that traders are able to profit and benefit from this in an unregulated space.

Almost a quarter of respondents opted for 'other' as a reason why trader onlending is concerning. When asked about other reasons, one banker said: *"Concerns over trader onlending depends on what the motivation is. Sometimes this happens because the two participants have an established relationship. For me, it is an issue if traders finance 'bad' projects which banks won't finance because of ESG risks. We have strict ESG policies, and this could mean that our RCF capital is inadvertently being lent towards something that we would never have approved internally."*

Not only does this cause concern in terms of environmental consciousness, but also means that the bank could be in danger of breaching regulation indirectly. As the banker puts it: *"Bank regulation is totally restrictive, but I don't see it as a problem because it's a license to operate in a safe environment."*

Figure 21: Banks' concern with traders using RCFs to onlend to smaller borrowers

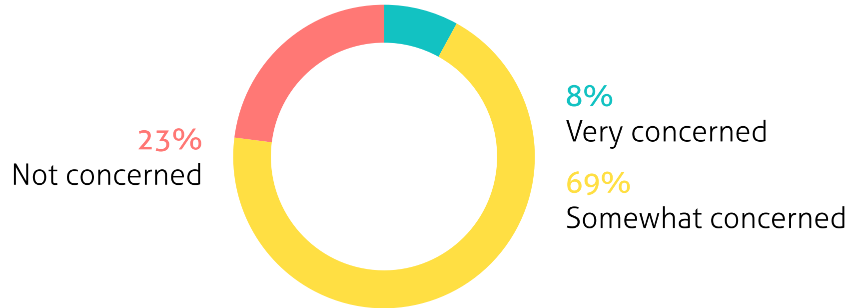


Figure 22: Reason why traders' onlending is a concern

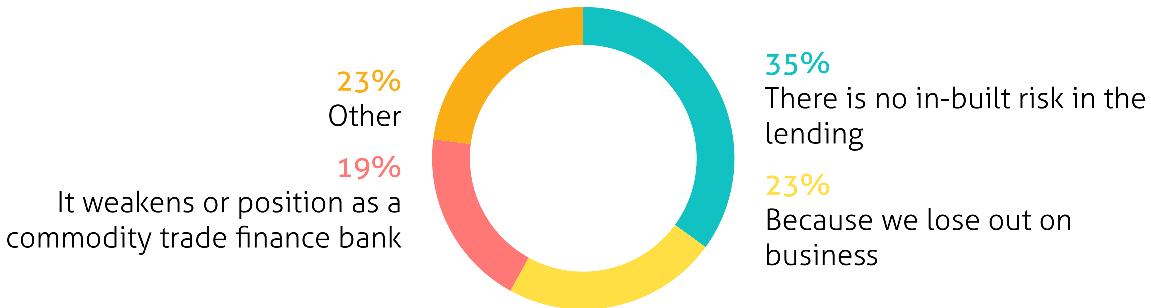
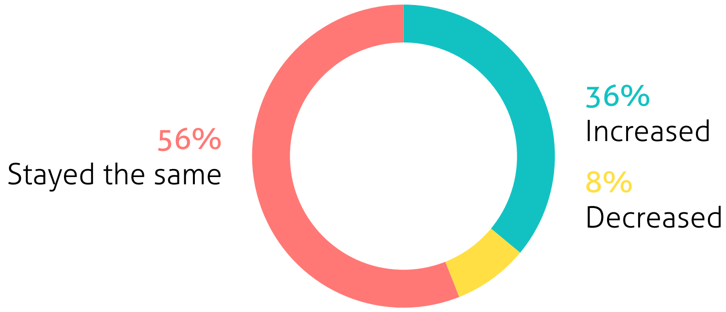


Figure 23 suggests an overall increase in bank threshold for transactional financing over the past 12 months. Although the majority of the sample (56%) reported that there was no change, 36% said that it had increased, and only 8% said it has decreased.

Figure 23: Changes in the banks threshold for transactional financing over the past 12 months



The majority of banks either agree (44%) or somewhat agree (33%) that the commodity trade finance landscape is drastically different compared to 12 months ago, with an overall similar percentage agreeing that the industry is in a healthier position, with 33% agreeing and 48% somewhat agreeing (Figure 24).

The largest percentage of banks agreed that there is more opportunity in commodity trade finance than 12 months ago (48%) compared to the other perceptions, with 41% somewhat agreeing. This is an overwhelming majority, with only 11% disagreeing with this point, which signals that perhaps the industry is recovering better than the TXF H1 2021 Data Report, which said deal volume had dropped by almost 50%, suggests.

Some respondents agreed that new banks were entering the space (26%) and a very minimal percentage (4%) said that former banks were re-entering the space, implying that commodity finance is mostly still accounted for by the same banks, with a small number of new additions.

Figure 24: Banks' perception on the commodity trade finance banking landscape

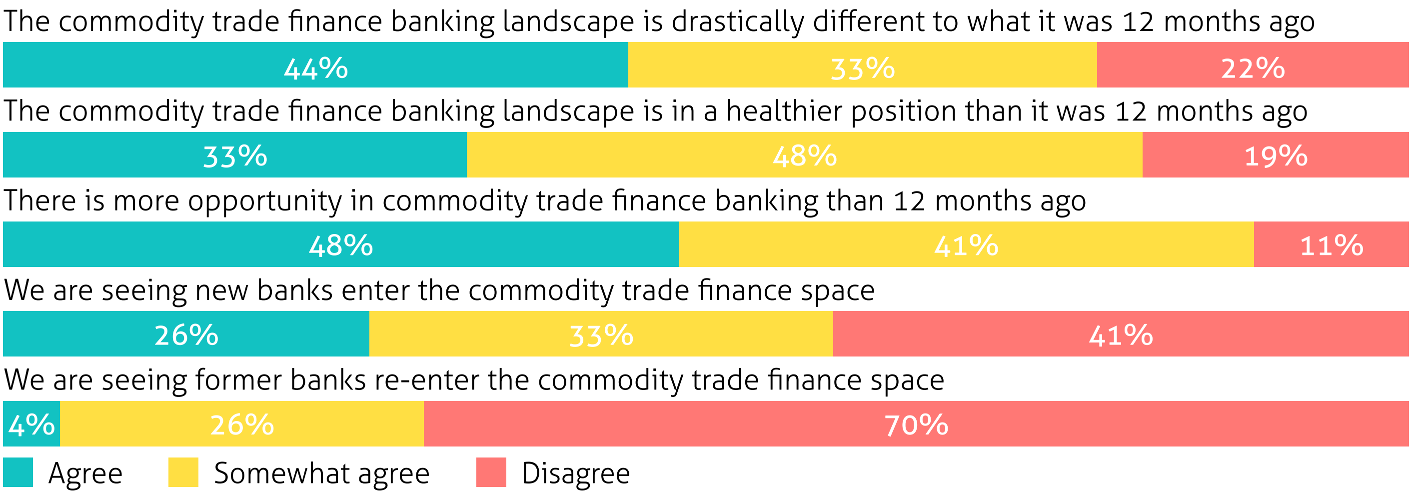


Figure 25 shows that 70% of respondents do business in Singapore, suggesting that the various high profile fraud cases in 2020 did not sufficiently deter banks from doing deals in the region. Overall, 39% of respondents reported that they finance borrowers in the Middle East. It is unclear whether this represents a year-on-year drop off, and the percentage could be smaller than Singapore's because Singapore has greater exposure to the commodity trade finance industry.

Almost a third (27%) of banks said that they do not finance deals in either jurisdiction, but again, it is not clear whether this is a year-on-year drop, or if it just represents banks which were not involved in these two jurisdictions in the first place. Overall, these data seem to suggest that Singapore and the Middle East are still in a healthy position, and that banks have not entirely blacklisted them as jurisdictions which they would not do business in.

However, there was some fall out across these jurisdictions, such as Societe Generale shutting its commodity trade finance in Singapore in August last year, ABN Amro retreating from the commodities industry as a whole and BNP Paribas significantly scaling back its operations in the industry amid a difficult few months of trading and the assortment of high-profile fraud cases in 2020.

Figure 25: Banks' involvement with financing borrowers in Singapore or the Middle East

Figure 26 shows that just under one fifth of banks have implemented TCFD (Task Force on Climate Related Financial Disclosures). The TCFD guidelines were released in 2017 and were established to improve and increase reporting of climate-related financial information.

In February this year, it was announced that the European Central Bank and the 19 national central banks of the Eurosystem will start making annual reports of the climate performance of their investment portfolios within the next two years, using the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) as the initial framework (Azizuddin, 2021). As it stands, 69% of the sample reported that they are unsure if the TCFD guidelines have been implemented at their respective banks, suggesting a lack of knowledge around the guidance.

But despite this, 29% of the sample said that they plan to implement TCFD practices within the next 12 months, and 35% said they plan to within the next 1 to 3 years (Figure 27). No respondents said they would wait between 4 to 5 years, and 35% said they would not implement TCFD at all. Overall, this implies that in three years' time, 64% of banks which have not already implemented TCFD will have implemented the recommendations by 2024, which is a significant progression.

Figure 26: Banks' commitment to TCFD

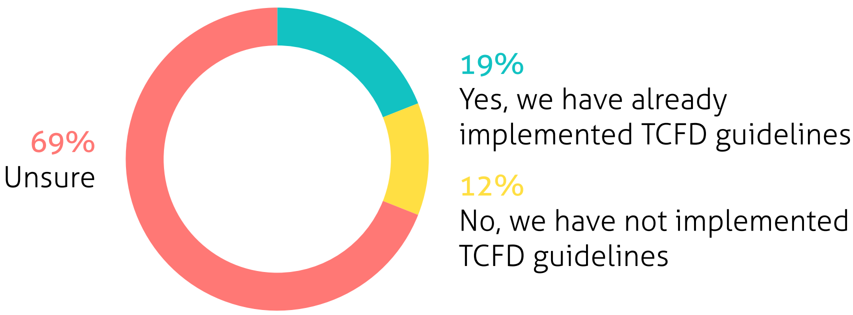


Figure 27: Banks' timeline to implementing TCFD

Figure 28: Banks' perception on whether they would forgo real-term price reduction to ensure borrowers commit to CSR

Figure 29: Average real-term price reduction for borrowers who commit to CSR

4.4
basis points

Figure 28 show that just over half of banks reported that they would forgo real-term pricing to ensure that borrowers commit to CSR, with the average reduction being 4.4 basis points (Figure 29). ESG-tied loans, which offer a margin reduction if the borrower can meet certain KPIs structured around improving its environmental, social, and governance criteria, have become very popular. But these data show that a significant 43% of banks are still not willing to offer a margin reduction to ensure that the borrower has met its ESG goals.

According to a bank which is willing to forgo price reduction for borrowers who commit to CSR: *"We only lend on ESG-tied debt when it has very clear and meaningful criteria. It needs to drive some tangible change and be void of greenwashing. As a bank, we play a big role in the energy transition and this is one way to incentivise corporates to develop their ESG strategies. Companies which have a good ESG strategy have a better future, and lower credit risk, so in the long run, it's a win-win, both environmentally and economically".*

Just over half of banks (57%) reported that they would not provide financing for high carbon supply chains, which is a relatively bold result considering that a reduction in carbon emissions was not something that would have been high on the agenda a few years ago (Figure 30). Not only does this show palpable progress in relation to the energy transition, but also suggests that sustainability awareness is evolving beyond the more immediate and obvious, as banks are avoiding high carbon emissions throughout the entire supply chain, rather than just directly from the relevant commodity.

Just over a third (35%) of the bank sample reported that they were concerned with the level of emissions in their supply chains, with 58% having said that they are somewhat concerned, and only a small minority (8%) reporting that they are not concerned whatsoever (Figure 31). This speaks volumes for how far the industry has come in recent years, as these data suggest that it has become the norm to be concerned about emissions, whether they are immediate or indirect.

Nearly two thirds (65%) of banks said that they produce annual ESG reports, with the remainder of the sample reporting that they do not (Figure 32). At this point in time, with the energy transition underway and with a higher emphasis on emissions, safe working conditions, sustainability, and everything else that comes under ESG, it is expected that the majority of banks produce ESG reports.

Many central banks, such as ING, now have multiple sustainability teams which deal with different areas of ESG. In ING's case, the teams are split into group sustainability, environmental & social risk, and sustainable finance (Howse, August 2021). Although this is relatively new, it is an indication of how sophisticated ESG is becoming within banks. However, not every bank has reached this level, and it is possible that some smaller banks are not yet producing ESG reports.

Figure 30: Perception on whether banks would provide financing for high carbon supply chains

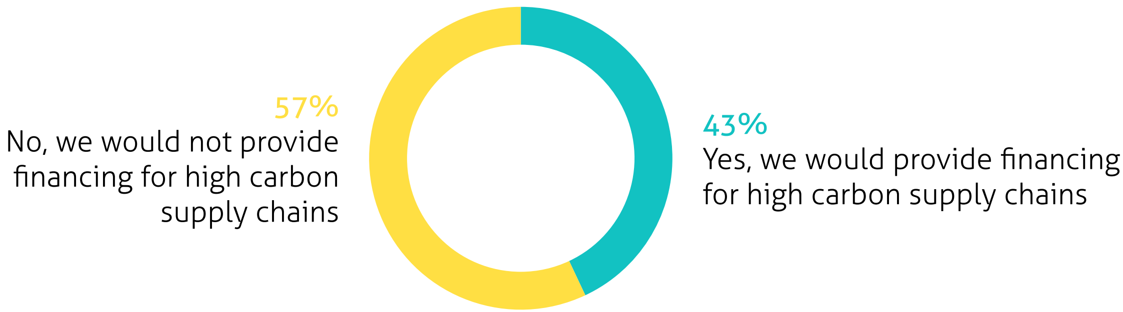


Figure 31: Banks' concern with the level of emissions of a supply chain

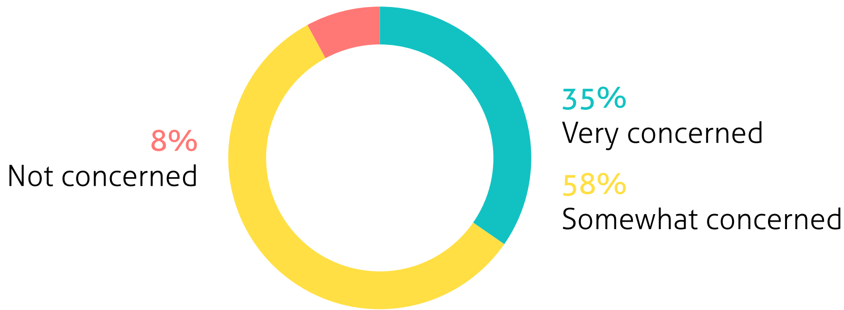


Figure 32: Banks' ESG publication rates

Figure 33 shows that banks are very divided when it comes to financing impact investments, with 48% saying that they do and 52% reporting that they do not. Impact investing is a relatively new term, referring to investments made with the intention to generate positive, measurable social and environmental impact alongside a financial return. In the case of commodities finance, this could be renewables, EVs, or sustainable agriculture, for example.

The divide shown in Figure 33 could be down to the relatively new nature of impact investing; as time passes and it becomes a more well-established norm, it is expected that the percentage of banks financing impact investing will go up. There is significant emphasis on the commercial banking sector to change in this regard. Many banks are already diversifying some of their portfolios away from hydrocarbon financing. As the energy transition progresses, over the next couple of decades we can expect significant diversification of bank portfolios. Increasing emphasis is likely to be placed on commodity-producing companies in all sectors, even oil & gas, ensuring that they are seriously committed to net-zero carbon emissions. And the issue of carbon emissions will most likely become a key requirement within sustainability-linked commodity financing over the coming years.

Figure 33: Banks and impact investing

According to Figure 34, the most important ESG-related value to banks is improving KPIs for agri/softs clients, with just over half (56%) of respondents agreeing that this is important and 37% saying that it is somewhat important. Not far behind this was improving ESG in the metals and mining industry, with exactly half of banks deeming this important and 38% reporting that it is somewhat important.

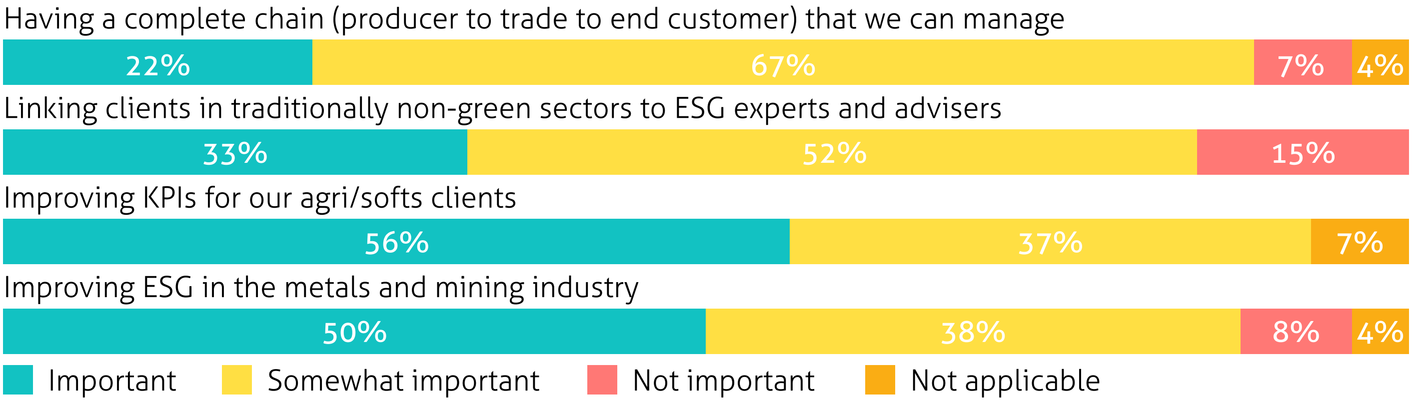
Both the agri/softs and metals and mining sectors have a lot of hidden sustainability impacts, such as circular supply chain emissions, pollution, and natural resource depletion, to name a few, and are also heavily associated with various human rights issues, such as unfair pay, child labour, and unsafe working conditions. There is still a lot of work to be done in these sectors to ensure that they are both safe and environmentally and socially sound, which is why improving KPIs and ESG in these areas of the commodities industry is important to banks.

Linking clients in traditionally non-green sectors to ESG experts and advisors was considered important to 33% of banks, and somewhat important to just over half (52%) of the sample. Particularly for smaller corporate clients, integrating ESG strategies can be a challenge, and they often need the help of larger, more established institutions, so it is promising that a decent percentage of banks recognise the importance of being that point of contact.

Considered the least important, with only 22% deeming it as important, and 67% considering it somewhat important, is having a complete supply chain that a bank can manage, from producer to trader to end customer. Although this would be an extremely positive thing for the banking industry, it is very ambitious and hard to achieve. The commodity trade finance industry is still working on improving the basics of ESG, such as human rights issues in mines in developing countries, so managing a complete supply chain is probably deemed the least important for this reason. Perhaps in the future, when the industry has a more sophisticated grasp on ESG as a whole, this will move higher up the agenda.

"We're in talks with various clients to try to inspire them to go beyond their own direct impact. In terms of emissions, this could mean looking into scope three emissions, or traceability, to reach further down the supply chain. But on the contrary, when structuring KPIs, it is vital that they are correct and can be measured and audited. The further away you go from the core business and operations of a company, the more difficult it becomes to obtain reliable data", says a European bank.

Figure 34: Most important values to banks



A look into the traders' and producers' world

- The importance of RCFs
- Corporates' commitment to TCFD

The corporates: In focus

Nearly two thirds of the sample (64%) believe that RCFs are very important from a borrowing perspective, with 14% considering them to be somewhat important and 22% voting for not important (Figure 35). RCFs offer a considerable amount of flexibility, allowing the borrower to withdraw funds as and when they need it throughout the maturity of the loan, which is why they are an important and popular loan option in the commodities industry, in which corporates tend to operate on razor thin margins in a volatile price environment.

As already discussed on page 19, some traders (19%) reported that they onlend a portion of their bank RCF debt to smaller producers which cannot necessarily afford or secure their own bank debt (Figure 36). This is mainly related to the largest commodity traders, as they are the companies which are able to secure massive annual RCF volumes at relatively low margins, and as such have the capacity to onlend to smaller corporates (producers and traders).

Figure 35: Importance of RCFs to borrowers

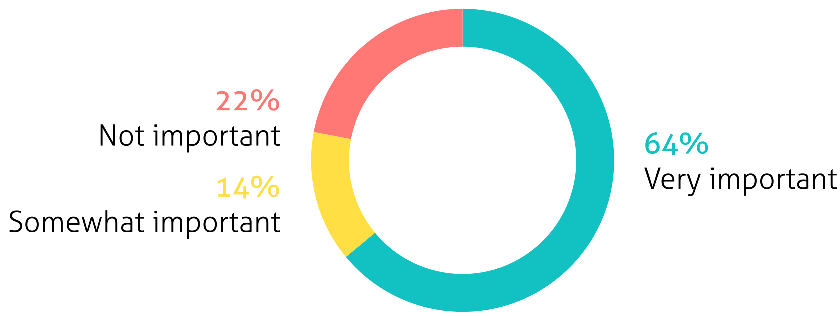


Figure 36: Rate of traders that onlend RCFs

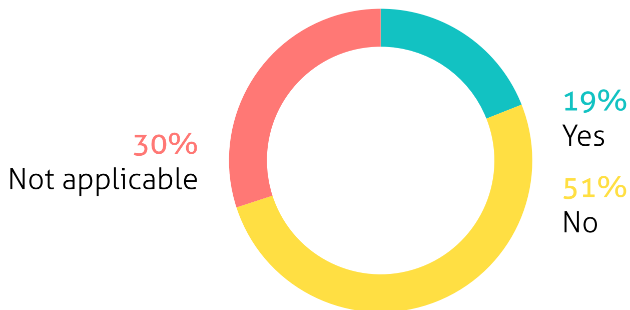


Figure 37 shows that only one fifth of corporates are committed to TCFD, with 38% reporting that they are not committed. The majority of the sample (42%) reported that they do not know whether they are committed to TCFD, which could be indicative of a lack of knowledge around the guidelines, or a lack of support to implement them, whether this is financial or educational support.

Echoing this sentiment, the highest percentage of respondents (45%) said they are not planning to follow TCFD practices, with the lowest percentage saying that they plan to implement it in the next 12 months (Figure 38). The remainder of participants said they are planning to implement TCFD practices within either 1-3 years or 4-5 years (26% and 17% respectively). This shows there is less corporate support for implementing TCFD compared to banks, of which the majority of the sample said they would implement TCFD within the next three years.

The pressure and motivation for corporates to implement ESG and sustainability related practices often comes from their banks and investors, hence why a higher percentage of banks are planning to follow TCFD practices compared to corporates. It should also be noted that it is harder for corporates to quantify the adoption of new practices, which could be one of the reasons why corporates are less willing to adopt TCFD practices.

Figure 37: Commitment of corporates to TCFD

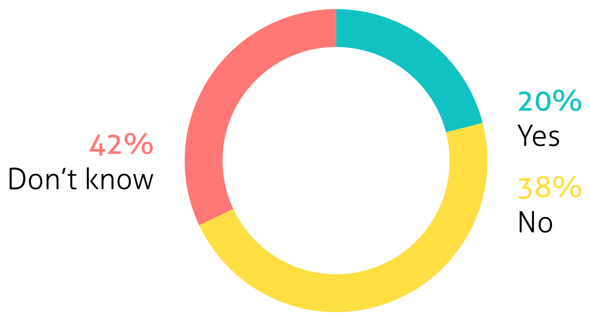
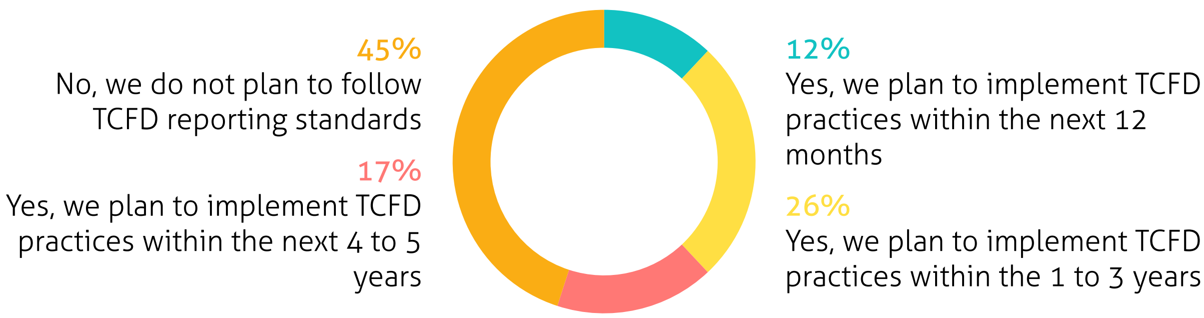


Figure 38: Timeline for corporates implementing TCFD



Where next for commodity trade finance?

The aim of this research was to explore the global commodity trade finance industry. Using a mixed methodology that combined 186 quantitative survey responses with detailed qualitative insights from ten consenting individuals, this report concludes:

Overall sentiment uncertain, but more so for corporates than banks. The industry is still suffering from the anomalous year of 2020 and is currently facing a multitude of headwinds. Increasing bank regulation, tougher competition, the looming energy transition, and inflation are all contributing towards an overall uncertain market sentiment. The 'flight to quality' that the industry is adopting essentially puts the power in banks' hands, as smaller corporates face increased scrutiny and struggle to secure financing. But margins are dropping after skyrocketing last year, which signals that the market is returning to a healthier state.

The majority of the industry is on board with digitalisation, including small organisations, but costs and lack of knowledge are holding back progress. With most of the sample reporting that they have either always recognised the importance of digitalisation in commodity trade finance, or are starting to see the benefits of it, it is more a matter of 'when' not 'if' digitalisation will become more widely adopted. The barriers perceived as the most detrimental were the more practical ones, which are likely to change and ease with time, such as costs and lack of knowledge, rather than barriers related to an unwillingness to change, or a lack of faith in digitalisation. Whether its adopting blockchain, or other forms of fintech, it is evident that the only way the industry will move is away from paper and towards digitalisation.

Most banks are at least somewhat concerned by secondary trader onlending, and the reasons for this are varied. While trader onlending is an important source of secondary debt for many smaller producers and traders, which may not be able to secure bank financing in the first place, it is also associated with some issues around lack of regulation and built-in risk. Although it might appear as if banks are to blame, heavy regulation can make it difficult for banks to lend to smaller players, and it can be a matter of inability to lend rather than unwillingness. There is a strong argument for a regulatory re-haul in the commodities industry, and if regulators, governments, and the WTO club together to push for a digitalised and standardised solution, there is a chance of making a tangible change which could help to lessen the funding gap in a regulated space.

Sustainability throughout the supply chain is on the agenda but is not yet the norm. Banks were divided when it came to willingness to provide financing for high carbon supply chains and whether or not they would sacrifice pricing for CSR, showing that although there has been progress, the industry has a long way to go amid the energy transition. But with only 8% of respondents saying they are not at all concerned with the level of emissions of a supply chain, it is clear that there has been a key shift in bank attitude in the past few years. Next on the cards will be developing strategies to regulate and reduce emissions throughout the supply chain, which will require full traceability as a starting point.

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About TXF Intelligence

TXF Intelligence is made up of two proprietary sources of information: Data and research.

The data tool presents the latest closed deal information within the commodity trade finance, and export finance sectors. The data has been specially structured to capture all the relevant and unique characteristics of these sectors and has become the go-to resource for benchmarking, business development, trend analysis and secondary market loan distribution.

The research tool presents the latest market sentiment across commodity trade finance, and export finance. Using an in-depth and robust methodology that combines quantitative trends with thought provoking qualitative insights, contextualised with closed deal market information and outside literature from reputable sources, the research reports present a unique and proprietary analysis of the latest trends across these markets.

Research team

TXF Research

Aife Howse | **Reporter (author)**

Dr Tom Parkman | **Head of research (analyst)**

Designer
Joe Wood

Acknowledgments

TXF

Jonathan Bell | **Editor-in-chief & director**

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