

The ACE Warehouse Receipt System

This is the third out of seven articles published by ACE to mark 15 years of operation and celebrating the regulatory license recently acquired from the Registrar of Financial Institutions.

The Warehouse Receipt System (WRS) is undoubtedly the greatest achievement delivered by ACE. Nearly all domestic banks have at some point been involved with the system, some peripheral, others with complete integrated commodity finance products. Close to all large agribusinesses in Malawi have an ACE certified warehouse and the majority have issued receipts for their own business purposes or to third parties storing with them. The Warehouse Receipt System is truly an industry infrastructure.

The tracks have been laid, the machinery has been oiled – now it is up to the combined industry to push the train into motion. Once it has reached scale and is running at speed, it will be very hard to stop. The Warehouse Receipt System is here to stay.

The Warehouse Receipt System and agricultural finance walk hand in hand. ACE has already experienced what can be achieved when the product is right. There can be no doubt as to the effect access to finance has on businesses as well as small holder farmers' ability to advance as commercial and profitable enterprises. Finance is such a strong proposition and it deserves its own article, so ACE has dedicated article six to finance. This article will touch on the other moving parts of the Warehouse Receipt System.

The Warehouse Receipt Act defines a warehouse receipt as a security under the Securities Act and the ACE Warehouse Receipt System is therefore effectively a central securities depository or registry. ACE is the system operator and with the recent commodity exchange license, **ACE will also regulate the system in capacity of a Self-Regulating Organisation (SRO), under authority and regulation of the Registrar of Financial Institutions.**

The registry will contain any information about a warehouse receipt and embody the receipts as documents of legal title to the underlying commodity. Any lien or right can be pledged or registered on the warehouse receipts to protect the holder of that right. Most common would be a financier's right to the commodity as collateral for financing or a buyer's right to the commodity as specified in a contract of sales.

The critical component of the Warehouse Receipt System, is the certified warehouses. These are crucial, as the integrity of the whole system is dependent on the warehouse operator's ability to guarantee the receipts they issue. The rules the Warehouse Receipt System has in place to mitigate risks, is what differentiates a receipt issued from an ACE certified warehouse from a warehouse receipt issued by any other warehouse. The Warehouse Receipt Act states that anyone with a warehouse for hire can issue a warehouse receipt. There is therefore no protection in the warehouse receipt itself. It is only as good as the warehouse who issued it.

Developed and mature warehouse receipt systems have strict capital and financial requirements for their warehouses to insure and secure their performance. The problem faced in setting up the system in Malawi, was that there was no appetite or ability for the warehouse operators to provide these financial guarantees. Had ACE introduced these safeguards, it is likely that ACE would have no certified sites at all. It is also a consideration that the cost of financial guarantees would translate into higher storage charges which again would limit interaction with the system.

It is a fine balance and a crucial element of the Warehouse Receipt System. ACE has taken the approach that the warehouse operator guarantees will have to be introduced gradually as volume on the system increases. So far, the bar that ACE needs to meet is the bar set by the financial institutions. If banks are happy to finance, then ACE, as the system regulator, is also content. **ACE does recognise, that the better protections can put in place, the more attractive the system will become to banks.** The Warehouse Receipt System need to move from being dependent on traditional collateral management to rely on guarantees from the warehouse operators instead.

ACE believes that the Warehouse Receipt System is an essential infrastructure. It is a catalyst for trade, finance and information. As mentioned in the first article, ACE started the Warehouse Receipt System with trade services in mind. There was a need for buyers to know that they would get what they contracted to buy. Too many times, and this still happens today, a seller would default if another buyer for some reason was deemed more convenient. This mentality of disregarding or disrespecting contracts is hugely detrimental to trade.

If a buyer buys a warehouse receipt, their right to the underlying commodity will be registered in the registry. This means they are protected. The owner of the commodity can't sell it to others or take it out of the warehouse. It is locked. The practical safeguard is the warehouse operator. A warehouse operator can only release commodity on a warehouse receipt if they receive a drawdown authorisation from ACE. This actually means that the counterparty to the warehouse receipt buyer, is in fact, the warehouse operator more than the seller of the commodity. This structure opens new doors when it comes to transacting with farmers and farmer organisations. **By introducing a reputable company as a service provider to the farmers, any buyer in the world can transact safely with that farmer. And that, ladies and gentlemen, is the end game for ACE.**

Promoting the Warehouse Receipt System is obviously also promoting quality storage. This aspect alone could drastically reduce post-harvest losses, estimated to be 15-20% in Malawi. The Warehouse Receipt System calculates a storage loss of 1%, so this substantial post-harvest loss reduction can contribute significantly to increased volumes towards food security or export markets.

Although ACE recognises that private sector involvement in the Warehouse Receipt System is a critical prerequisite for success, ACE also wanted to promote that farmer organisations adopted the system and, like private sector, offered services to their farmers and members. The traditional model in Malawi is that the farmer organisation will buy produce from the farmers and sell then onwards to a buyer. Basically making the farmer organisation a trader or middleman. Many farmers in Malawi have been cheated by this set-up, both by the farmer organisation management and by traders tricking the farmer organisation leadership. ACE has also seen, too often, that the farmer organisation is paying low prices for the produce, earning considerable margins which fail to trickle down to the farmers again. ACE is, however, happy to report, that there are some truly fantastic associations out there, who are really servicing their farmers well. **ACE believes that the Warehouse Receipt System can be a tool to lead the farmer organisations in the right direction.**

ACE has been constructing warehouses for farmer organisations so they can take full ownership of their Warehouse Receipt System integration and thereby limit their reliance on private sector. Farmers can now deposit the commodities in their own warehouses and keep ownership of the commodity. The farmer's organisation will handle, treat and store the commodity and maybe also find a buyer. Instead of a trade margin, as in the model above, the farmer's organisation will now charge a service fee for the work they do. **This model will empower the farmers in their own structures.** The financial model shows that warehouse operations will be sustainable at 50%

utilisation of a 500MT warehouse. **This will be possible to achieve for many farmer's organisations, but it requires considerable support.**

Of course the end vision is that a farmer organisation as an entity can be sustainable by offering services to its members. This will require larger warehouses and more volumes. We are not quite there yet!

A central proposition of the Warehouse Receipt System is to enable farmers with the option to delay the sale at harvest time, where prices traditionally are very low. The first requirement is access to the warehouse and the second could be access to finance to ensure that the farmer is not forced to sell because of cash needs. The decision to delay the sale is a speculative decision and one can never be certain that you will profit from that decision. The volatile market prices do not assist the farmers in Malawi, or the region. Article six will cover this issue with more depth. **However, the facts are that the prices after harvest are low, often below cost of production and having the choice to store and maybe access finance, will increase the farmer's options. A farmer with choices is a farmer with opportunities.**

ACE would like to see the Warehouse Receipt System integrated with the operations of the National Food Reserve Agency (NFRA) and ADMARC. These agencies should be offering storage against warehouse receipts. Both NFRA and ADMARC are in a constant battle to get the budget they need to buy commodities. It is great when they have funds and manage to buy early in the season. Farm gate prices always increase. However, they hardly ever manage to do that. This current season is no exception.

ACE is promoting an alternative. Both ADMARC and NFRA should open their silos and warehouses at the beginning of the season. All farmers can deposit and get a warehouse receipt (an ACE warehouse receipt would of course be preferred). Banks could be integrated and they could offer finance – for example just 50% of the market value, just to ensure that farmers have some cash. Ideally, Government could take some finance risk from the banks to ensure attractive interest rates. ACE has no doubt – Malawi could fill up public storage spaces in the first couple of months of the season if funds or finance were available.

If there is a humanitarian need or ADMARC needs to implement price stabilising policies, then Government can buy the receipts at market price. Either first in / first out or at a competitive auction. If Government doesn't need to buy, then Malawi must allow export so farmers and traders can empty the storage and prepare for the new season. There shouldn't even be a need for a food reserve, but Government can buy and carry over a preferred volume of stock to the new season. This is transparent, predictable and the market will respond favourably. ACE is certain it could transform the markets, especially maize, and bring back incentives to produce and export.

ACE is happy to report that both NFRA and ADMARC leadership are very open to these ideas. ACE is optimistic and the fact that the Warehouse Receipt System has been included in all major agricultural policies, the intense work done on the regulatory framework led by the Ministry of Industry, Trade and Tourism and lately the initiatives from the Reserve Bank of Malawi to create a strategic Government road map for structured trade; fuels the optimistic feeling that ACE will be able to table our ideas in the near future.