Private Cash Fuels Commodity Trade as Banks Step Back

By Reuters

Wednesday, March 13, 2013

GENEVA (Reuters)—Private investors and hedge funds seeking new ways to gain exposure to commodities may provide a lifeline to trading houses desperate for the short-term liquidity that banks used to offer.

European banks have cut their lending in commodity trade finance, the $1.5 trillion-a-year business of financing oil shipments or copper deliveries, ahead of Basel III restrictions aimed at reducing systemic risk after the 2008 financial crisis.

Lending cuts coincide with traders' growing need for funding due to high commodity prices, especially for oil, where a single shipment can cost more than $200 million at current Brent crude prices.

The liquidity crunch has thrown some trading houses into crisis — forcing several to close or consider takeover bids from bigger competitors, accelerating sector consolidation.

"Investors want a piece of what banks can make in lending to traders," said Jacques-Olivier Thomann, president of Geneva's Trade and Shipping Association.

Some new investors were prompted to try new ways of getting exposure to commodities after being disappointed by investments in the handful of publicly listed trading firms, Mr. Thomann said on the sidelines of a conference.

To fill the funding gap, two former bankers from one of the biggest traditional lenders, BNP Paribas, have started a firm called Commodity Trade Invest, they told Reuters.

Jacques Begle, former co-head of trade finance at BNP, and **Philippe Steiner** say they will specialize in structuring the type of deals that helped once-small trading houses in Geneva grow into sector giants such as **Trafigura** and **Vitol**.

"Banks are upscaling their criteria radically. They also want equity of $5 million and a cash margin. The banks have also become so heavy that they are no longer able to deliver decisions on time for trading houses," said Mr. Begle, CTI's president.

"It's a service that we have outsourced from the banks to investors. They want exposure to the real economy through merchant trading and this is a new alternative for them," added Mr. Steiner, who is vice president.

They said the company expected to offer investors a 4 percent to 15 percent margin, depending on risk appetite, and would target borrowers with annual revenues of $100 million to $500 million. Investors are expected to include hedge funds, corporations and private investors known as "high net worth individuals."

Traders or Bankers?

Large trading houses that have come out trumps in the recent market consolidation are becoming lenders in their own right. While some trading firms have opted to expand into commodity trade finance, such as Trafigura via its **Galena** fund, others have been pushed into it to meet customers' needs for credit.

"Now we are asked more and more to give credit to the roasters," Nicolas Tamari, chief executive of coffee trading house Sucafina, said at the Tuesday conference. "We are sort of becoming what we're not supposed to be: financiers, banks. That's not healthy."

Trading houses are not covered by the Basel III rules, although regulators have questioned whether they should come under regulations that apply to the so-called "shadow banking" sector, according to a Swiss government official.

Mr. Begle warned that for small trading houses to borrow from bigger competitors poses inherent risks to their survival.

"There's a conflict of interest," he said.

Wealth Managers

Private banks have also begun to show interest in providing funding for commodity traders, including Hinduja Bank which last year doubled its commodity trade finance team.

"There is a traditional know-how in the private banks...and it would make a lot of sense to structure the right vehicles to private bank customers to invest in trade finance instruments." said Guillaume de la Ville, a professor at the University of Geneva's commodity trading diploma course.

Pictet Wealth Management's chief investment officer **Yves Bonzon** said the Geneva-based bank would consider lending to commodity trading houses but did not yet have a dedicated service.

"Essentially it's an asset management activity so why not? The only caveat is to produce the kind of returns banks do requires some leverage and we are not very keen on leverage in general," he said.

Mr. Thomann said the scale of new entrants in the business of lending to commodity traders was still small and entailed greater risk for investors than borrowing from a bank.

"You can always find a pool of private investors willing to put up $10 million for a specific deal outside the banking system," he said. "But in those transactions you lose the institutional structure, the bank due diligence and its risk management tools."

By Emma Farge