**Executive summary**

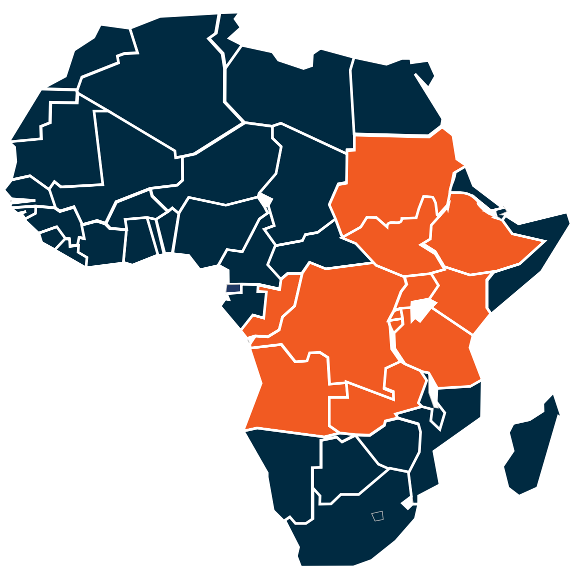
# The barriers to financial access for the responsible minerals trade in the GLR

**Client**

PUBLIC-PRIVATE ALLIANCE *for* RESPONSIBLE MINERALS TRADE

**Focus**

Great Lakes Region (GLR)



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Sofala Partners Limited

www.sofalapartners.com | info@sofalapartners.com

For the full report, please visit [www.pparmt.org](www.pparmt.org).

## Introduction

This report, delivered by Sofala Partners and BetterChain, follows a Request for Proposal to conduct research on the roles of – and barriers to – financial institutions in promoting responsible minerals trade from conflict-affected and high-risk areas (CAHRAs), issued by the Public-Private Alliance for Responsible Minerals Trade (PPA) in November 2018.

The report's purpose is to provide insights, analysis and data – based on extensive interviews with industry participants and financial institutions – that can inform future initiatives designed to achieve the ultimate goal of a fully traced and validated supply chain that is both scalable and self-sustaining. The report's scope of enquiry covers the role of financial institutions (and of industry partners that provide financing) in both the responsible tin, tantalum, tungsten (3T) and gold supply chains (together, the '3TG' sector). The focus is specifically on the Great Lakes Region of Central Africa, including the Democratic Republic of Congo, in the interest of assessing challenges and opportunities in CAHRAs.

### About this report

This report has been authored by Sofala Partners and BetterChain with review and comment for consideration by members of the PPA Governance Committee and Projects and Resources Work Group. The findings and analysis are solely those of the authors and do not necessarily reflect the position of the PPA or its individual members.

*About the PPA*

The PPA is a multi-sector, multi-stakeholder initiative that works to improve due diligence and governance systems needed for ethical mineral supply chains in the Great Lakes region of Central Africa. It responds to the global call for action to break the link between the illicit minerals trade and violence, human rights abuses and rebel groups, and to support projects and dialogue to improve the due diligence and governance systems needed for responsible minerals sourcing and trade. For more information, see www.pparmt.org.

## Executive summary

### Identification of issues and mapping of financial flows

**Upstream supply chain participants in the 3TG sector (such as miners and exporters) require access to finance to fund a range of needs,** from trade operations and working capital to investments in improving the efficiency of mineral extraction and meeting the costs associated with responsible sourcing of minerals. To some extent, the challenges differ between the 3T (tin, tungsten and tantalum) and gold sectors, but in both cases there are bottlenecks in the flow of finance at each stage of the supply chain.

*Financing gaps along the 3T supply chain*

**In the 3T sector, the trade of minerals from the upstream to the midstream level of the supply chain is usually based on advanced payment from the buyer to the seller,** which creates cash flow problems and a gap between up-front costs and receivables. For example, 'négociants' (the local term for local traders in DRC) act as middlemen to purchase from miners and are commonly pre-financed by DRC-based exporters with between US$100 - US$1,000 per day. However, '*coupures de fond*' (cash flow challenges) are common, as there is no banking system at this level of the supply chain and mineral price fluctuations create uncertainty.

**Négociants are typically affiliated to several exporters and 're-sell' minerals to the highest bidder, creating a risk of re-payment delay (often of several months) for exporters that have provided money advances**, and a preference only to advance funds to trusted négociants. In this way, unsecured pre-financing of négociants creates cash flow problems for locally-based exporters seeking to aggregate supply volumes in the DRC.

Further along the supply chain, **the nature of the payment loop between DRC-based exporters, smelters and global traders creates a structural cash flow challenge for global traders**, as traders are only paid once the smelter has received shipment and payment has been made to the intermediary (usually 3 to 5 months after the trader first advanced monies to a locally-based exporter).

That said, **international trading companies are generally able to manage financing challenges in the 3T sector,** as they are typically able to access finance outside of the DRC. Global trading firms also mitigate the risk of late or non-payment by providing advance payments only to trusted DRC- and Rwanda-based suppliers that can demonstrate adequate financial records and proof of compliance (for instance, through participation in a recognised upstream due diligence programme). Global traders and their banks do view DRC as a high credit risk jurisdiction, but such trading firms are generally comfortable buying from DRC as long as this represents only a small percentage of the group's overall global activities, as their risk is diversified.

For their part, **3T smelters have limited incentive to offer inventory finance to upstream players.** There is little upside for 3T smelters to advance funds to multiple suppliers because the level of competition in the midstream part of the 3T value chain is much lower than in the gold sector, and so supply volumes are rarely under threat. In the tin sector, for example, the global smelting market is dominated by just two companies. Hence, for global smelters, the risks and costs involved in advancing payment to DRC-based suppliers outweigh the potential benefits.

*Identifying the key barriers to bank credit and payments in the 3T sector*

At the upstream level, **neither artisanal miners nor local traders or cooperatives are able to obtain access to finance through financial institutions,** as the high level of informality at this level of the supply chain means that these actors are unable to meet loan application requirements. Instead, they rely on cash-based finance and on payment advances from one supply chain actor to another, with no bank involved. 3T exporters, as the most solvent and well-organised actors in the upstream supply chain, have better prospects – in theory – of obtaining bank finance locally. In reality, however, the loan conditions imposed by Congolese banks – which include high rates of interest, overly rigid collateral requirements and no grace period on repayment – are not appropriate to the business models of these exporters. As a result, many exporters do not seek loans in the local banking sector.

In contrast to the difficulty of accessing loans, **making bank payments is not a major challenge for established trading firms, who face few problems when making payments in US Dollars in DRC or Dubai.** While US banks are more likely to block payments due to the perceived jurisdictional risk in the DRC, European banks and banks based in the Gulf are generally happy to transact in the DRC, leaving sufficient options available for exporters (especially as many DRC-based exporters have parent/sister companies in Dubai).

**Of all the upstream actors in the 3T supply chain, local exporters in the GLR that are part of a wider multi-jurisdictional conglomerate have the best ability to overcome access to finance challenges**, as they are typically able to arrange low-cost financing either in-house (through cash flow from other operating divisions) or offshore. Dubai is the preferred banking jurisdiction for this type of conglomerate as money transfers in the UAE are straightforward (typically 20 USD per transaction regardless of the amount), and loan requirements are less rigid. In contrast, it can be very slow to open a bank account in DRC, often taking up to one year, and transfer fees are also much higher.

*Gold sector overview*

**In the gold sector, the dynamics are different as the shadow (smuggling) economy is by far the largest component of the overall ASM gold economy,** and the underlying dynamics of the illicit gold trade shape the challenges and opportunities facing the much smaller legal gold sector. Smuggling is institutionalized and involves not just rebel or criminal groups but government and army figures, rendering the 'conflict minerals' label misleading. The highest volume smuggling route for ASM gold from DRC is via Uganda, where the business and political elite is reportedly directly involved in the trade.

**Our research identified five critical disincentives to formalisation (and therefore to financial access) for DRC-based artisanal gold operators:**

1. Upstream gold supply chain participants are both *unable* to access legal forms of credit due to their informality/high-risk borrower status and *unwilling* to access credit because interest rates from local banks are often higher than their margin on gold sales.
2. The tax burden on legal gold exports from DRC is high and tax-paying actors incur a 'double penalty' due to their greater visibility and exposure to extortion.
3. Due diligence costs for artisanal operators are prohibitively high (unless donor or exporter-subsidized), and there is no recognized sector-wide due diligence programme.
4. The scale of the illegal trade makes it hard to create a premium for legal/traceable gold because money launderers and cash-scarce businesses bid up the price of illegal gold. Hence, it would be challenging to create a large-scale bifurcated market for gold (featuring a premium price for responsibly sourced gold) as expensive traceable gold will always be undercut by the buoyant non-traceable market.
5. The legal DRC gold sector is undercut by firms in Rwanda/Uganda engaging in regulatory arbitrage, whereby Ugandan/Rwandan companies who buy illegal smuggled gold originating in DRC enjoy lower costs than their DRC-based counterparts, due to the friendlier operating environment in their host countries. In this way, illegal gold mining and mineral trade activities generate more value for local supply chain actors than compliant ones: the core challenge is to reverse this equation so that the formal/traceable gold sector is attractive on its own terms to artisanal miners.

**Interviewees observed that the smuggling incentive and the perverse incentives created by high taxation in the DRC overshadow the access-to-credit issue as the key barriers to formalisation for ASM**. At the root of the smuggling incentive is the fact that gold is not just a mineral commodity but also a financial instrument and a store of value in its own right. As such, in the ASGM sector, it is impossible to separate assessment of the barriers to financial access from the broader barriers to formalisation. As in the 3T sector, the ASM gold trade is based on a pre-financing system, but for gold the system runs on highly opaque cash-based payment advances rather than more formalised arrangements.

**Examples of traceable and legal ASM gold production in DRC are limited**. IMPACT's Just Gold project[1] and USAID's recently-concluded CBRMT project[2], located in Ituri Province and South Kivu Province (eastern DRC), respectively, aim to trace conflict-free and legal artisanal gold from mine site to export while applying regional and international standards applicable to conflict-affected and high-risk areas; however, gold volumes have been low, representing a challenge to sustainability and scalability. (Low supply volume is problematic in the context of the cost economics of the sector, as gold shipments need to be relatively high volume to achieve cost-recovery.)

## Analysis of the barriers to financial access

*Overview*

For both local and global banks**, the poor ratio between (high) financial risk and (low) financial return represents the greatest obstacle to engagement in the ASM sector**. In particular, the informal characteristics of individual artisanal mining operators represent a critical barrier to bank lending. Banks refuse to engage with artisanal operators as nearly all such operators lack a formal management team, legally-recognised corporate structure, a proven record of financial accounts, access to traditional definitions of collateral (banks do not recognise the types of collateral that ASM gold operators have to

[1] The Just Gold project is an on-going project implemented by the NGO IMPACT (formerly Partnership Africa Canada) in the eastern DRC. The project aims to bring legal, traceable, and conflict-free artisanal gold from communities where security and human rights are at risk to international markets.

[2] The Capacity Building for Responsible Minerals Trade project (CBRMT) was funded by USAID and implemented in DRC by Tetra Tech between June 2014 and December 2018. The project aimed to strengthen the capacity of national and regional stakeholders to establish and scale up responsible, conflict-free mineral supply chains for gold, tin, tantalum, and tungsten (3Ts).

offer), and adequate financial and information management systems. All of these are basic requirements for loan application processes in the formal financial sector. Additionally, artisanal miners are mobile, creating a high perceived risk of loan default.

*Perceptions of risk: commercial risk vs reputational risk*

At present, **no financial institutions provide finance to ASM in the DRC on a sustainable or scalable basis.** This is primarily due to commercial considerations: i.e. the perceived financial risk is too high. Stimulating direct lending by local banks to artisanal operators is therefore likely to require extensive technical assistance, grant funding and a 'blended finance' approach designed to reduce financial risk exposure for banks. However, a key barrier to this kind of multi-stakeholder approach is that Development Finance Institutions (DFIs), which could potentially play a catalytic role by providing concessional finance and guarantees, are highly sensitive to reputational risk and will not commit to investments unless they meet full IFC Performance Standards; yet no artisanal operator in DRC can meet these standards. Hence, there is a two-step challenge: first, DFIs needs to get comfortable from a reputational risk standpoint; and only after this can DFIs become involved in mechanisms that could help take enough of the financial risk off the table for commercial banks that lending to ASM becomes commercially viable.

*Specific barriers to financial access in the gold and 3T sectors respectively*

**In the gold sector, banks view artisanal upstream supply chain participants as particularly high-risk**. There is a widely held negative perception among both banks and DFIs that ASGM is high risk because gold is easy to smuggle, hard to trace and represents a fungible store of value. The influential Financial Action Task Force (FATF)[3] has drawn an explicit link between gold and money laundering risks, which has permeated global banks' perception of integrity risk in the sector. All banks interviewed for this report drew an explicit link between non-industrial gold production and the risk of money laundering, and noted that the due diligence costs to eliminate this risk were too high for ASM gold.

**By contrast, 3Ts are an input to a manufacturing process and are more traceable. Banks accordingly view 3Ts as lower risk from a reputational perspective than the gold sector**. As such, the barriers to finance in the 3T sector are often more commercial in nature – there is little commercial upside for banks to engage with small-scale players, in a sector that is sub-scale – rather than compliance-related.

*In-depth: key issues in the Congolese banking sector*

**The relatively small, illiquid and conservative nature of the Congolese banking sector presents its own specific issues.** For instance, from a borrower perspective, even when credit is available, interest rates and payment transfer fees at local banks can be prohibitively high, and loan tenors lack flexibility: SME loans in the DRC range from 15% to 22% interest (though higher rates are charged in the microfinance sector on loans to individuals). Loan tenors are typically 1 to 3 years. No grace period is offered on re-payment of the principal sum, and this is a key obstacle as most artisanal operators cannot repay immediately.

**Moreover, in general, the operating model at Congolese banks is not focused on business lending,** but rather on a low-risk model of (i) making a profitable spread between low interest-bearing cash deposits and high interest bonds; and (ii) charging high fees on money transfers and currency exchange. A related point is that the balance sheets of local banks are too small to lend at the exporter-level, so local banks would need to pool credit to lend effectively in this space. A related point is that local

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[3] The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system.

banks have not invested in development of in-house capacity to understand and measure financial risk in the specific ASM sector context – this remains unfamiliar territory for loan officers.

**A key barrier to ASM lending is inflexibility on definitions of loan collateral:** Bank decisioning processes are typically predicated on hard, non-moveable/non-transferable collateral, such as land or buildings. In DRC, 150% collateral is normally required to obtain a loan. More workable forms of collateral that better reflect the nature of the ASM sector would be: (i) exporters could use a formal offtake agreement as collateral; (ii) ASM actors could use a real-time cash-flow reporting mechanism, or forward purchase agreements, as collateral; (iii) independent geological studies could be used as collateral (under this approach, the bank or a trusted third party such as an NGO would commission an independent assessment of the value of the minerals within the '*Zone d'Exploitation Artisanale*' over which the operator or its suppliers have legal rights); or (iv) an innovative alternative option would be to rollout a rent-to-own or pay-as-you-go mining equipment leasing business model whereby a mobile instalment method of payment, plus remote device tracking, eliminates the need for collateral.

*Upstream responsible minerals trade due diligence*

**Interviewees for this report were clear that while participation in upstream due diligence programmes (e.g. iTSCi) provides access to global markets, they currently provide limited benefit in terms of access to finance. Therefore, cross-recognition of different due diligence standards is required,** along with a change of culture among banks and DFIs, replacing 'disengagement by default' (whereby the reaction to any identified risks is to disengage entirely) with a collaborative risk mitigation approach that starts with an agreed minimum standard of compliance (fit for purpose for ASM) on a journey to full compliance.

*Linking upstream due diligence to financial access*

**There is a clear need to link upstream due diligence to financial access.** However, the number of compliant upstream actors, particularly in the ASGM sector, is low. Upstream due diligence programs have been slow to innovate and have struggled to achieve scale. The main reason is cost. The due diligence cost is passed on to local miners without any meaningful offsetting compliance premium on prices, thereby creating an illegal trade incentive. The key determinant of cost is access to reliable on-the-ground information – the more that reliable information can be produced and shared openly in an automated or semi-automated way, the lower the cost of conducting effective upstream due diligence.

*Perceptions of ASM in the financial sector*

**An important overarching finding from our interviews is that artisanal mining has a universally negative image among global financial institutions**. This is because (i) global banks have a lack of knowledge of the ASM sector and its importance to local economies; (ii) global banks often only encounter the subject of ASM as a risk factor to be mitigated when financing industrial mines, rather than as an opportunity; and (iii) banks are accustomed to lending to legally incorporated companies with standardised corporate governance frameworks and hard asset collateral. The spotlight shone on ASM by global NGOs may also inadvertently have reinforced this reluctance by global banks to engage with the sector. Hence, over and above the specific issues highlighted in this report, there is a need to close the 'knowledge gap' that exists in the financial sector regarding ASM.

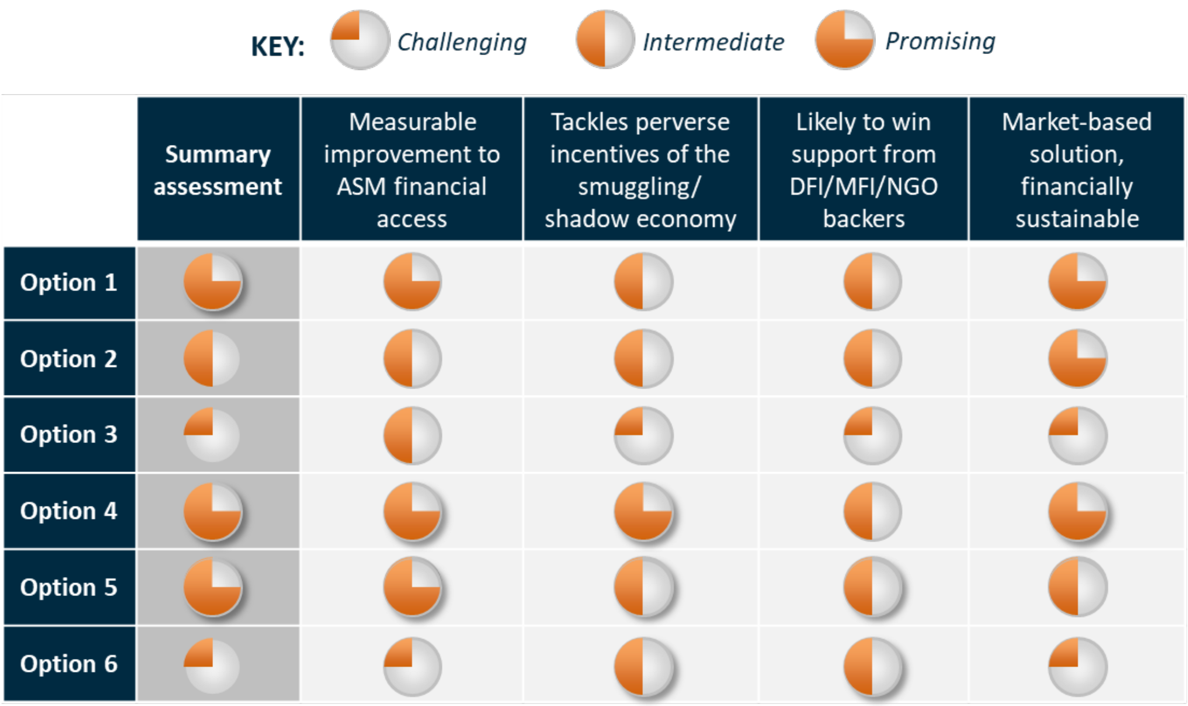
## Towards an integrated approach to overcoming ASM access to finance challenges

We identify six design concepts for a financing facility to unblock access to finance for ASM, listed below. These six conceptual options are not mutually exclusive: in practice, elements could be drawn from each to develop a tailored approach.

Critical success factors for any of the following proposals would include a partnership between the bank/fund and a development partner (the International Finance Corporation, to take one example) in which new decisioning processes can be designed jointly that are tailored to ASM; in addition to a multi-stakeholder coalition approach involving industry, banking associations and development partners in order to build trust and familiarity across the financial sector for new ways of working.

| | |
|---|---|
| **Option 1** | Establish a financing facility within a bank or fund to provide ASM sector loans |
| **Option 2** | Create a financing facility to support mining firms that integrate ASM suppliers |
| **Option 3** | Set-up inventory financing arrangement between refiner/smelter and exporter |
| **Option 4** | Create 'Hub & spoke' exporter facilitation under a known/responsible exporter |
| **Option 5** | Create a stand-alone impact fund to lend to artisanal operators in 3TG |
| **Option 6** | Establish a challenge fund for innovative and scalable solutions to ASM financing |

Below, we provide a high-level verdict on the pros/cons of the six design options, ranked against key criteria:




**Our primary recommendation would be to combine the most attractive elements of Options 1 and 5 to establish an ASM lending unit within a leading local bank** (selected on a competitive basis), governed by a 'fund-like' performance framework that provides a line of credit and properly incentivises the bank to lend to artisanal operators (e.g. with a bonus/financial upside for the bank if an agreed number of ASM sector loans are successfully extended and repaid). In effect, this approach combines the performance incentive structures of a fund into a traditional line of credit and/or loan guarantee scheme for a bank. The lending unit would be supported by a robust grant-funded Technical Assistance facility focused on provision of on-the-ground due diligence compliance and capacity building support for ASM loan recipients.

In addition, we believe that Options 3 and 4 represent viable approaches for the gold sector in particular. Indeed, some interviewees suggested that **global gold refiners could become part of the solution to the access-to-finance challenge by providing financial services to responsible ASM suppliers off their own balance sheet, or by leveraging their own preferential terms of credit**

**on behalf of upstream suppliers.** This intra-supply chain finance concept is a fast-growing field and could reduce both the cost of money transfers and the likelihood of payments being blocked. Unlike in the 3T sector, there is significant competition between gold refineries for supply, and these competitive dynamics may incentivise refiners to partner more closely with suppliers. One gold refiner has trialled this approach recently in Latin America; while another is reportedly developing in-house financing solutions, thus blurring the traditional distinction between refiner and bank.

Whichever approach is taken**, we believe that access-to-finance solutions should focus primarily on the most organised and most solvent entity in the upstream supply chain, i.e. the exporter,** rather than on artisanal miners. Exporters can then provide advance payments and support the formalisation of artisanal operators in their own supply chain, for example working under a 'closed-pipe' model where all suppliers are known and validated.

### Stakeholder engagement and outreach recommendations

The table below outlines a roadmap of actions and engagements for the PPA and/or other organisations seeking to engage with ASM to consider pursuing. It is important to note the intrinsic link between access to finance for ASM and closer integration/partnerships between ASM producers and business partners in the supply chain: many of the highest potential opportunities for unlocking access to finance for artisanal operators involve strengthened business partner support and engagement, either directly through supply chain finance or indirectly through changes in business partner approaches to financing, risk mitigation and upstream engagement.

We identify four levels of engagement: funding, stakeholder engagement, outreach, and technical assistance:

| Category | N° | Actions |
|---|---|---|
| Stakeholder engagement | 1 | • Engage with the OECD to co-develop a multi-year global strategy / campaign to "re-brand" the image of ASM in the financial sector, and to bring more financial institutions into the dialogue on RMT in CAHRAs. The PPA and/or other organisations seeking to engage with ASM could form/convene a Task Force - jointly with the OECD - that includes progressive and influential financial institutions with a demonstrated commitment to progressing the ASM access-to-finance agenda. |
| Stakeholder engagement | 2 | • Engage with potential donors (e.g. World Bank/IFC, AfDB, USAID, etc.) to support the development of ASM expertise within leading local banks in the GLR |
| Stakeholder engagement | 3 | • Engage with LSM gold companies to promote the importance and benefit of the ASM sector (e.g. through the RAGS Forum) |
| Stakeholder engagement | 4 | • Engage with DFIs/MFIs to raise awareness of (and demonstrate with evidence-based research) the significance of the ASM sector as a critical and under-appreciated driver for social and economic development in CAHRAs. |
| Stakeholder engagement | 5 | • Engage with downstream firms to apply pressure on financial institutions to engage with ASM and to reward responsible sourcing. |
| Stakeholder engagement | 6 | • Engage with trade associations (LBMA, RJC, RMI) to promote proactive risk mitigation rather than default disengagement. This could include co-development of model risk assessment decision-making processes. |

| | | |
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| Stakeholder engagement | 7 | • Engage with downstream firms to promote better cost optimisation of upstream due diligence. Leverage the demand of downstream players for access to valuable upstream information. |
| Stakeholder engagement | 8 | • Engage with MFIs and DFIs to implement a guarantee program jointly with a local bank targeting the ASM sector in the GLR, in order to create a demonstration effect for a local financial sector that historically has not engaged with ASM or viewed the sector as commercially viable. |
| Stakeholder engagement | 9 | • Promote lessons learned from impact investors' experience in investing in the ASM sector to attract a broader range of financial institutions into the sector. This could include a communication campaign focused on promotion of success stories and de-bunking negative perceptions. |
| Outreach | 10 | • Support efforts to harmonise mining and mineral trade taxes across the GLR |
| Funding | 11 | • Support initiatives that promote a performance-based, sub-commercial approach for ASM loans that recognises the significant non-financial positive 'returns' on offer from unlocking access to finance to ASM. |
| Funding | 12 | • Support existing and planned initiatives which increase the value to upstream players generated from formal trade in 3TG (i.e. initiatives that make the ASM sector commercially attractive) |
| Technical assistance | 13 | • Support the development of globally recognised benchmarks and standards to link upstream due diligence programmes to financial sector transaction due diligence: work with relevant stakeholders such as the OECD on the alignment of minerals due diligence reporting and financial due diligence requirements. This work could begin with the formation of a working group of global banks with broad representation (meeting bi-monthly in-person or by conference call to share experiences and approaches to date and to work towards a draft framework). |

## Critical success factors

✓ To achieve impact and behavior change among the global financial community, any planned initiative should include financial institutions not just from the US but from a broad range of global capital centers, as attitudes toward ASM in CAHRAs differ between banks in the US, Europe, the Gulf (e.g. Dubai), Africa and Asia.

✓ We recommend focusing on partners that are genuinely willing and able to support identified goals. This will require (i) conducting an in-depth stakeholder prioritization exercise tailored to the specific project/programme objectives; and (ii) recognizing that governments in the GLR often support initiatives (e.g. on tax harmonization) rhetorically, but to date have largely not implemented necessary changes. On a more practical level, it will be important to secure commitment from members (including governments) up front that they can allocate sufficient time, and have capacity, to help deliver on the programme's goals.

✓ Alignment with existing programmes and organizational structures will be crucial. Any planned new programme should begin with a comprehensive mapping of existing initiatives that may overlap, with a view to aligning resource commitments and objectives to the fullest extent possible. An example in this context is the five-year USAID-funded Commercially Viable, Conflict-Free Gold (CVCFG) Project, which seeks to strengthen the responsibly sourced gold supply chain originating from eastern

DRC. This project "aspires to improve access to markets for artisanal and small-scale mining cooperatives and facilitate international responsible ASM gold trade" and is led by Global Communities.

- ✓ Effort should be focused on projects or programmes that are long-term, scalable and market-driven (i.e. effect positive behavior change through price signals and cost competitiveness, rather than through regulations or one-off investments).

- ✓ The programme design process should recognize that issues limiting ASM access to finance cannot be treated in isolation; rather, they are intrinsically linked to the wider barriers to ASM formalization.

- ✓ Any new programme should include a sustainable funding model. Donor funding can kick-start the platform, but self-funding platforms (e.g. based on collection of member fees) are more self-sustaining in the long term and ensure that members have 'skin in the game'.

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