An African Case For The Luxembourg Rail Protocol

Africa is a continent of opportunity. Truth be told, it's also sometimes a continent of risk. For South African and multinational companies looking to establish businesses or partnerships in some of Africa's less commercially or legally secure zones, there is a need for a level of risk assessment and mitigation when deals are brokered. This is particularly true in the case of the rail industry – set to be a key factor in Africa's transformation – where assets are costly and projects are of an infrastructural nature. It's no small feat to get a locomotive across borders, but it's a steep risk if there is no legal framework in place to ensure that the interest in the asset is protected. Enter the Luxembourg Protocol.

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Jacques de Klerk - GPR Leasing

The Rail Working Group represents the position of the rail industry relating to adoption and implementation of the 2007 Luxembourg Protocol to the Cape Town Convention on International Interests in Mobile Equipment on matters relating to railway rolling stock (commonly known as the Luxembourg Rail Protocol).

The Luxembourg Rail Protocol is a worldwide legal framework that recognises and regulates the security interests of investors in railway rolling stock. It then establishes a public international registry, to be located in Luxembourg and operating 24/7, in which the interests may be registered and searched for via the internet. It benefits lenders, lessors and vendors selling under conditional sale agreements and applies to all rolling stock. It creates a common system for repossession of assets on default or insolvency of the debtor, making it particularly helpful in respect of equipment that crosses borders. By better securing investors, it will attract more private capital into the industry at cheaper rates, according to Rail Working Group chairman Howard Rosen. "In many cases, particularly in Africa," Rosen states, "the Protocol will be an essential precondition for private finance and will stimulate operating leasing of rolling stock; a major step forward for operators in the future."

As finance rates drop and funders' views on residual values become less conservative, the daily cost for operators will decrease markedly. The European Union has already ratified the Protocol (in respect of its competence) as has Luxembourg and a growing number of European countries. Countries outside Europe, including South Africa, are working towards this. The international registry is expected to begin operations in 2017.

The Rail Working Group has thus been encouraging the rail industry to press for the Luxembourg Rail Protocol's prompt signature and ratification. Generally, however, the Protocol is not yet well understood within the rail and finance industries when it comes to its practical benefits.

Having recently brokered a successful rail leasing transaction in Cameroon, GPR Leasing (a Grindrod Rail and Pembani Remgro Infrastructure Fund joint venture) and Rand Merchant Bank, a division of FirstRand Bank Limited, two members of the Rail Working Group, are well placed to explain how the process would have been smoother, had the Protocol been in place.

Greg McKenzie, of Rand Merchant Bank's Investment Banking Asset and Infrastructure Finance division, points out that there is a similar protocol

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already in place that governs international interests in mobile equipment on matters specific to aircraft. "With the Luxembourg Protocol, we are trying to apply the same principles to railway equipment," he says.

Recently, Rand Merchant Bank was approached by GPR Leasing regarding a potential rolling stock leasing deal of four locomotives to a client in Cameroon.

McKenzie explains that Rand Merchant Bank does not have a presence in Cameroon or view it as a strategic jurisdiction at this point in time. "If there is a South African company wanting to do business there, Rand Merchant Bank will support them to the extent that they can externalise certain risks," he says. "This was the case with GPR Leasing – because we were concerned about certain risks in this jurisdiction, we required support from GPR Leasing's shareholders that they would take the expropriation risk in order for Rand Merchant Bank to finance the deal. Having done our due diligence, we also recommended that GPR Leasing take out political risk insurance to further mitigate any political risks in Cameroon."

If, however, the Luxembourg Protocol had been adopted by Cameroon, either of these mitigation measures may not have been deemed necessary and the financier could have placed greater reliance on the collateral of the financed assets.

"The Protocol wouldn't help with the risk of rental default or debtor insolvency, but it would assist with securing our interest in the asset if it occurred," McKenzie explains.

With the Protocol in place, there is reduced risk for funders and lessors, Jacques de Klerk of GPR Leasing notes. "We would normally not need political risk insurance, which would lower our expenses, and there would be the possibility of better interest rates," he explains.

McKenzie adds that the definition of mobile rail assets as set out in the Protocol also apply in the broadest sense, from locomotives to wagons, trams, metro trains, cable cars, monorails and gantries, and cranes running on tracks. Ratification of the Protocol would therefore also benefit ports, harbours, governments and private sector businesses outside of direct rail industry operators in terms of attracting investment.

"This is not a theoretical protocol developed in Europe with no practical application in Africa," says De Klerk. "In fact, the ratification of the Luxembourg Protocol by African states would have a direct impact in terms of securing foreign investment, negotiating credit rates and speeding up the deal-making process."