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Financing railway rolling stock: A new solution for Africa

The Luxembourg Rail Protocol – confronting the hard questions

The Luxembourg Rail Protocol to the 2001 Cape Town Convention on International Interests in Mobile Equipment, will, by giving secured creditors more security, make it much easier and cheaper for the private sector to finance new and existing railway rolling stock across Africa. Railways are not just a critical part of a sustainable development agenda but also a key element in a regional and continental economic integration strategy. Railway rolling stock is very broadly defined and includes any vehicle which runs on tracks or above, on or under a guideway. The Protocol will provide a new common system of international security rights for creditors (secured lenders and lessors) whose interests will be registered, and searchable 24/7, at an international registry to be based in Luxembourg. It will lower the barriers to entry for operators and lead to a more competitive and dynamic rail industry worldwide – bringing important social, environmental, developmental and economic advantages as well as new business opportunities. But there are still questions to be answered

Q: The Protocol puts the cart before the horse. Investment in rail infrastructure should come first.

A: Actually the procurement of rolling stock should work in parallel to the building or rehabilitation of the rail infrastructure. Rolling stock cannot operate without serviceable infrastructure but then building the infrastructure without the rolling stock would be a huge waste of money. Moreover the cost of the rolling stock could amount to a third of the total cost of the project. If this can be laid off to the private sector, it will considerably lighten the financing burden on government.

Q: How do we know that the Protocol will really save money for operators?

A: Every country will be different but it will on four distinct levels:

- By reducing lender risk, it will make bank funding cheaper as the banks allocate less of their capital under the Basel capital adequacy rules (and therefore

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allow them to reduce their margins) but even for non bank creditors, the reduction of risk should mean a reduction of margin

- By introducing a *common* international system of rules for creditors, this will encourage more non specialized finance to come into the market and therefore reduce cost because of the increased availability of finance. It will also comfort lenders being asked to finance rolling stock moving across borders (and make the finance cheaper).
- Export credit agencies are discounting their risk premia by 10% under an agreement under the auspices of the OECD where the equivalent aircraft protocol to the Cape Town Convention is in operation
- Documentation and transactional structures will be much more straight forward and therefore less costly.

Q: Why is the Protocol beneficial to states even if they wish to continue to finance rolling stock on their balance sheets?

A: The underwriting of operating leases for the rail sector (like aviation) by the Protocol will help operators in offering them a more flexible way to manage their key assets, entering into financial commitments for limited periods in accordance with operational needs. More operating leasing will result in a much larger residual value market for rolling stock, making it easier for states and operators to monetize existing, unrequired, rail equipment and reducing residual value risks for lessors, thereby resulting in lower primary lease rates. Operating leases also create an economic driver towards standardisation of rolling stock (because standard equipment is easier to remarket and therefore has a higher residual value) and it allows manufacturers to recognise more economies of scale which will ultimately be for the benefit of the operator procuring new equipment.

Q: What is the benefit if the URVIS (unique rail identification system) introduced under the Protocol?

A: For the first time, under the Protocol, there will be a global system of identification of all rolling stock. It will help not just making it easier to track and manage rolling stock in real time for operators, financiers, insurers and regulators but open the way to predictive maintenance on rolling stock. Automatic periodic major maintenance checks are wasting \$ millions. In the future we can maintain rolling stock when it's needed and in line with utilization rates. Moreover, latest technology is making it possible to use tagged wagons to locate deficiencies in the tracks as long as these are uniquely identified.

Q: When will the Protocol come into force?

A: There are two conditions for the Protocol to enter into force. There must be at least 4 contracting states and the secretariat to the Preparatory Commission must certify that the international registry is ready to operate. At the moment we expect the Protocol to start operation in late 2019 or early 2020.



Q: Which African states have adopted the Protocol?

A: The Protocol has so far been adopted by Gabon and has been signed by Mozambique (currently working on ratification). However the Protocol is under active review by the states of South Africa, Burkina Faso, Ghana, Nigeria, Kenya, Uganda, Mauritius, Senegal and Ethiopia. The comparable aircraft protocol to the Cape Town Convention has already been ratified by 23 states across Africa.

Q: Why should African states adopt the Protocol when there is limited adoption in other parts of the world?

A: It's coming. Luxembourg and Sweden have already adopted the Protocol together with the European Union. France, Germany, Switzerland, Italy and UK have already signed the Protocol and are proceeding to ratification. We expect Malta, Denmark, Finland and Ukraine to sign the Protocol shortly and other states such as China, Indonesia, Ireland, Spain and Hungary have all launched studies into its adoption.

Q: Is there any point in single African states adopting the Protocol?

A: Absolutely, since it will greatly assist in attracting private finance for the procurement of various types of rolling stock operating domestically (including trams and light rail) but it is not optimal. We encourage states to work together on a regional basis adopt the Protocol so that locomotives and wagons crossing borders will be protected by the same set of rules and therefore will be financeable by the private sector. This is particularly important as the Luxembourg Protocol, if it is adopted across Africa, will underwrite many of the SDGs and the progression of the African Continental Free Trade Area. By providing the financial means for states and their agencies to transport goods seamlessly across the continent.

Q: Which African states attended the diplomatic conference in Luxembourg in 2007?

A: 7 African states attended the diplomatic conference: Algeria, Cameroon, Gabon, Kenya, Nigeria, Tanzania and Togo as well as the Southern African Development Community (SADC).

Q: What other African involvement was there in the preparation and negotiation of the Luxembourg Protocol?

A: The Luxembourg Protocol is sponsored by two intergovernmental organisations, UNIDROIT, the International Institute for the unification of private law and OTIF, the Intergovernmental Organisation for International Carriage by Rail. The states of Egypt, Nigeria, South Africa and Tunisia are member states of UNIDROIT and OTIF's membership includes the three Maghreb states; these states would have been consulted during the preparation of the Luxembourg Protocol and some may also have participated in preparatory meetings. The Luxembourg Protocol is a protocol to the Cape Town Convention which was adopted in Cape Town in 2001, was hosted by the South African government and attended by many African states.



The Convention sets out the basic rules for securing creditors and the Luxembourg Protocol applies those rules, taking into account industry circumstances, to the rail sector.

Q: Why has it taken so long for the Protocol to come into force?

A: The average time between a diplomatic conference agreeing an international treaty and it coming into force is 15 years. Nonetheless, implementation of the Protocol has been delayed for a number of reasons. In Europe, the European Commission insisted on the European Union adopting the protocol first before member states could proceed (competence on this treaty is split between the Union and member states). EU adoption only took place at the end of 2014. The Preparatory Commission, coordinating ratifications and implementation, also had to negotiate a detailed agreement with the prospective registrar for the registry in Luxembourg and this took several years. Again the agreement was only finalised in 2014. UNIDROIT decided not to reach out to states to adopt the Protocol until it could be sure that the registry would be ready to operate once the requisite number of ratifications (4) had been reached.

Q: Is the adoption of the Luxembourg Protocol dependent on rolling stock operating on a particular gauge?

A: Absolutely not. The Protocol applies to all rolling stock regardless of which gauge it operates on. However, to the extent that rolling stock, operating on a common gauge, crosses jurisdictional borders, then this opens out a major benefit of the Protocol if those contiguous states have adopted the Protocol.

Q: Will there be any incremental costs for African states adopting the Protocol?

A: Not at all. The only possible costs for contracting states are those of adopting the Protocol and implementing legislation. On the other hand, the Protocol will relieve governments of significant financial burdens.

Q: How do governments take the first steps to adopt the Protocol?

A: Although within government, one department will hold the dossier for the Protocol, it is relevant for various government departments and agencies. Inevitably the departments of Transport, Planning and Economic Development, Industry, Justice, Foreign Affairs and Finance will all have an interest and different roles to play. The most productive way forward, we suggest, would be to set up a half day workshop with senior representatives from each of these departments as well as any state rail agencies/operators where representatives from the UN ECA and the Rail Working Group would make presentations - and answer other important questions.

For more information and articles on the Luxembourg Rail Protocol see www.railworkinggroup.org