



SPI Project:

Law on bank guarantees

**Regulatory Impact Assessment
Approach Note**

Background* - 1

Bank guarantees play an important role in commercial contracts due to their capacity to secure performance in an environment where partners with different backgrounds are called upon to do business together. In general, countries have specific bank guarantees laws or ratify relevant international conventions (see below) that clearly define the rights and obligations of the parties involved and balance the interests of the beneficiary against the need to protect the principal against unfair claims.

In Romania, there is no specific law on bank guarantees. The disparate and incomplete legal provisions (from the Civil and Commercial Code, Law no. 99/1999) that have some relevance in addressing the issues pertaining to bank guarantees leave unclear numerous aspects, among which the most important are:

- the delimitation between the principal obligation resulting from the commercial contract and the obligation resulting from the bank guarantee;
- the extent to which the bank issuing the guarantee is bounded to pay the beneficiary based on his simple written request;
- the extent to which the issuing bank can invoke the exceptions stipulated in the principal contract;
- the extent to which the bank issuing the guarantee has the right to revert against the principal for recovering the guarantee amount and any other costs paid and not honored by the principal.

Background* - 2

In international trade, bank guarantees are governed almost exclusively by the law of the country of the bank which issues the guarantee to the beneficiary. Likewise, the International Chamber of Commerce (ICC) issued in 1992 a set of “Uniform Rules for Demand Guarantees” (ICC Publication no. 458) that have achieved a broad international recognition.

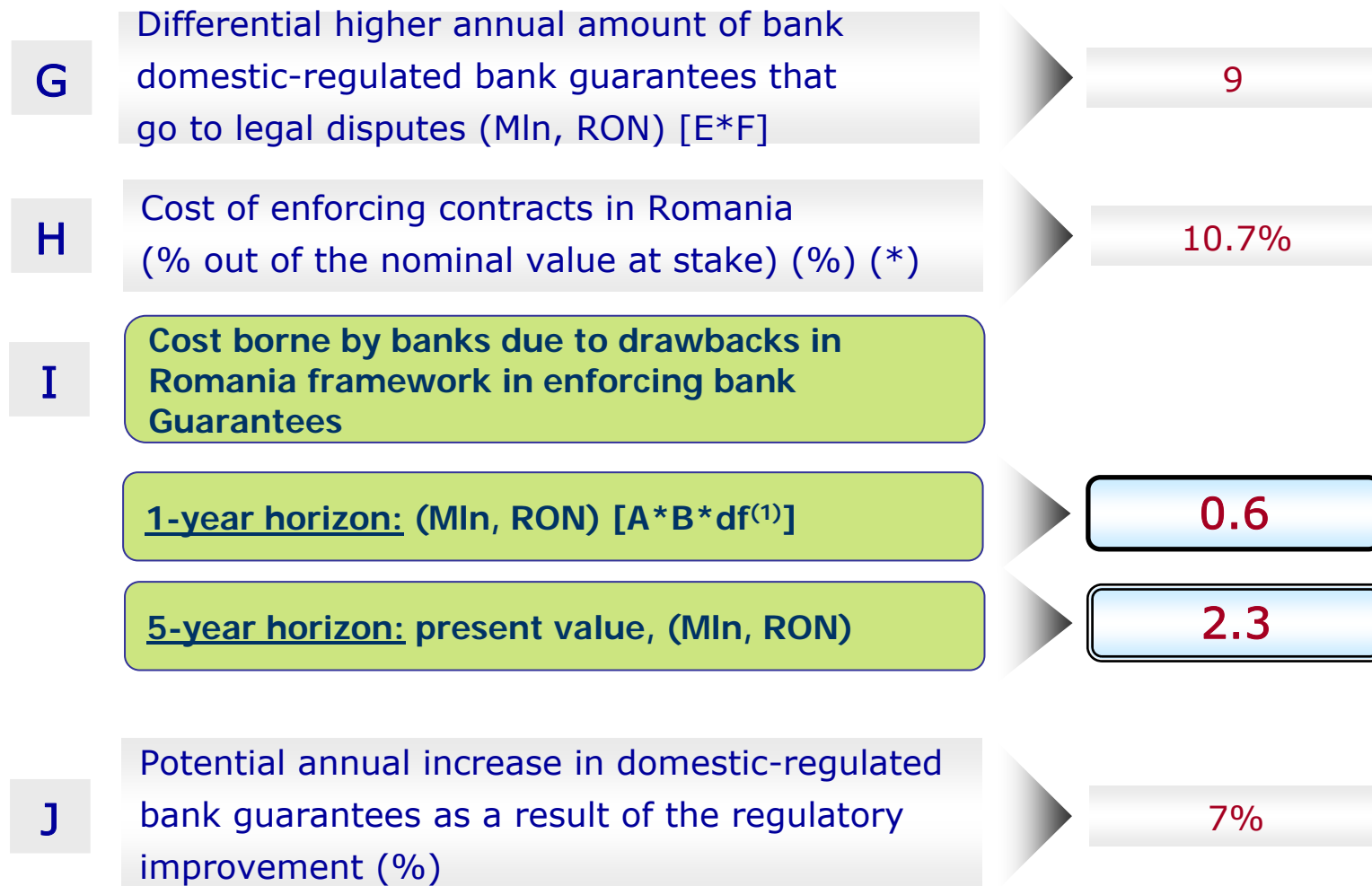
In issuing letters of guarantee, Romanian banks make reference either to the Romanian law or to the regulations from the parent entity’s country. This practice may result in unfavourable decisions to Romanian banks due to the incompleteness of the Romanian legislation on the matter and to the limited knowledge of Romanian courts of international rules.

In order to help overcome the drawbacks in enforcing the bank guarantee contracts, an RBA group has put together the principal terms of a proposed guarantees law.

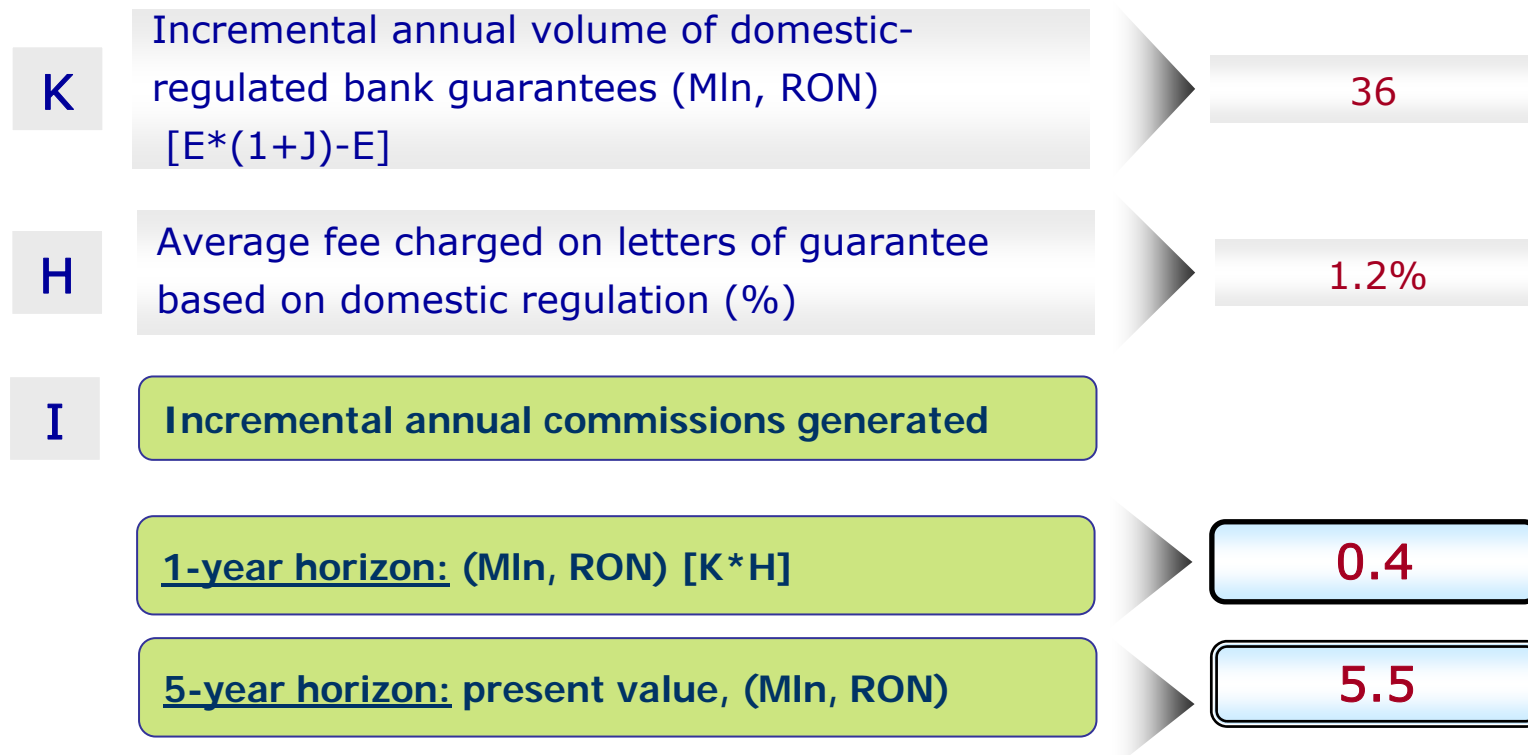
Economic impact assessment - 1

A	Banks' commitments to a natural entity or non-bank, legal entity (Mln, RON) (*)	12,887
B	Share of bank letters of guarantee (%)	20%
C	Exposure at the basis of bank letters of guarantees (Mln, RON) [A*B]	2,577
D	Domestic-regulated bank guarantees (%)	20%
E	Amount of bank letters of guarantees regulated by the Romanian law (Mln, RON) [C*D]	515
F	Higher rate of litigation for domestic-regulated contracts vs foreign-regulated ones (%)	1%

Economic impact assessment - 2



Economic impact assessment - 3



Analytics - 1

Commitments to a natural entity or non-bank, legal entity (Mln, RON)	a)	12,887
Incidence of bank letters of guarantee (%)	b)	20%
Exposure at the basis of bank letters of guarantees (Mln, RON)	c)=a*b	2,577
Domestic-regulated bank guarantees based on Romanian law (%)	d)	20%
Amount of bank letters of guarantees regulated by the Romanian law (Mln, RON)	e)=c*d	515
Higher rate of litigation for domestic-based contracts vs foreign-based ones	f)	1.0%
Higher annual amount of bank domestic-based bank guarantees that go to legal disputes (Mln, RON)	g)=e*f	5.2
Cost of enforcing contracts in Romania (% out of the nominal value at stake)	h)	10.7%
Annual cost borne by banks due to drawbacks in Romania framework in enforcing bank guarantees (Mln, RON)	i)=g*h	0.6
Potential annual increase in domestic-regulated bank guarantees as a result of the regulatory improvement (%)	j)	7%
Incremental annual volume (Mln, RON)	k)	36
Average fee charged on letters of guarantee baseed on domestic regulation (%)	l)	1.2%
Incremental annual commissions generated (Mln, RON)	m)=k*l	0.4

Analytics - 2

		2007	2008	2009	2010	2011	
Annual cost borne by banks due to drawbacks in Romania framework in enforcing bank guarantees	i)	0.6	0.6	0.6	0.6	0.6	
Potential annual increase in domestic-regulated bank guarantees as a result of the regulatory improvement (%)	ii)	7%	7%	7%	7%	7%	
Gross annual volume (MIn, RON)	iii)=d*(1+ii)	552	590	631	676	723	
Incremental annual volume (MIn, RON)	iv)=iii-d	36	75	116	160	208	
Average fee charged on LGs baseed on domestic regulation (%)	v)	1.2%	1.2%	1.2%	1.2%	1.2%	
Incremental annual commissions generated (MIn, RON)	vi)-iv*v	0.4	0.9	1.4	1.9	2.5	
PV - Annual cost borne by banks due to drawbacks in Romania framework in enforcing bank guarantees (MIn, RON)		0.5	0.5	0.4	0.4	0.4	2.3
PV - Incremental annual commissions generated (MIn, RON)		0.4	0.8	1.1	1.5	1.8	5.5

5-years

Discount rate (%)	7.10%				
Discount factor	0.933707	0.871808	0.814013	0.76005	0.709664

Analytics - 3

Data and assumptions:

a) Share of LGs in total off-balance sheet exposure	20%
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(Based on the evidence from Annual reports of a sample of Romanian Banks)

b) Guarantees that make reference to Romanian law (%)	20%
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c) Higher rate of litigation for domestic-based contracts vs foreign-based ones	1%
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d) Potential annual increase in domestic-regulated bank guarantees as a result of the regulatory improvement (other things being equal, e.g. foreign-regulated bank guarantees)	7%
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e) Average fee charged on letters of guarantee based on domestic regulation (%)	1.2%
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(Based on the evidence from some Romanian Banks contracts)