

Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



Bucharest, April 3, 2007

Mr. X

Dear Mr. X,

Invitation to act as a Local Independent Expert for SPI Project on Law on Bank Guarantees

A project working group composed of representatives of the banking community, National Bank of Romania, Ministry of Justice and Ministry of Public Finance has been set up in order to prepare a bank guarantee law proposal that would improve the enforceability of banking contracts. The recipient of the proposal is the SPI Committee, a high-level public-private body that oversees projects that aim at modernizing Romania's financial sector.

We are enclosing the Project Terms of Reference, a preliminary Regulatory Impact Assessment and the minutes of the project working group meeting for your information.

We would be honored if you would kindly agree to carry out the tasks specified in the enclosed draft Technical Anchor Terms of Reference. Although your assignment would be contracted by the Convergence Program, you would report to the Project Manager and be supported by the SPI Secretariat.

We would very much appreciate your feedback on the proposed terms of reference.

Sincerely,

Constantin Barbu
RBA Director
Project Owner

Janfred Silberstein
National Bank of Romania
Project Manager

Tudor Taslaoanu
Alpha Bank Romania
Deputy Project Manager

Annexes

SPI Committee Secretariat:

Ms. Oana Nedelescu, SPI Committee Secretary and SPI Director of Analytics and Policy

Ms. Ramona Bratu, SPI Director of Bank Products and Services

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Proposed Terms of Reference for Local Independent Lawyer

Project: Law on Bank Guarantees

Project Owner: Constantin Barbu (RBA)

Project Manager: Janfred Silberstein (NBR)

Deputy Project Manager: Tudor Taslaoanu (Alpha Bank Romania)

Project Working Group: Banks (5 experts), NBR (1 expert), MoPF (1 expert)

Local Independent Expert (LIE) Role

Project Objective:

To provide the Project Working Group (PWG) with a draft law on bank guarantee that meets the banking industry needs and that is aligned to the Romanian general legal framework, using a methodology that ensures the timelines promotion and smooth enactment of the law.

Role:

It is expected that LIE will perform the following functions:

During the project:

- Prepare a first issues paper with the main business and jurisprudence goals of the proposed law and an appropriate background section on the Romanian and international experience, with SPI Secretariat and RBA support;
- Prepare a methodology for drafting the law;
- Prepare the law outline;
- Prepare the draft law.

Project advocacy:

- Get the Peer Reviewer's, NBR and MoPF representatives in the PWG's opinion on the methodology;
- Get PWG agreement on the law outline;
- Present the draft law in the PWG meeting and ask for feedback;
- Get Peer Reviewer's opinion on the draft law;
- Discuss and include the suggestions and comments made by Peer Reviewer, NBR, RBA, MoPF opinions in the draft law.

Reporting:

Project Management.

Estimated Time of the Assignment:

LIE's assignment is expected to take about two months work in Bucharest.

Output:

1. a first issues paper;
2. a methodology for drafting the law;
3. the law outline;
4. the draft law.

Work plan

No.	Action	Deadline	Comments
1.	Sign the STC contract	April 13	
2.	Prepare a first issues paper with the main business and jurisprudence goals of the proposed law - and an appropriate background section on the Romanian and international experience.	April 18	SPI Secretariat and RBA will offer LIL the entire available documentation and support
3.	Prepare a methodology for drafting the law	April 18	If considered necessary by the PMG
4.	Get PR's opinion on the methodology	April 20	With SPI Secretariat support
5.	Get NBR and MoPF representatives' opinion on the methodology	April 20	With SPI Secretariat support
6.	Prepare the law outline	April 20	
7.	Get PWG agreement on the law outline	April 25	With SPI Secretariat support
8.	Prepare the draft law	May 25	
9.	Present the draft law in the PWG meeting	May 25	With SPI Secretariat support
10.	Ask for PR's opinion on the draft law	June 4	With SPI Secretariat support
11.	Discuss and include the suggestions and comments made in the draft law	June 11	In co-operation with the PWG

TERMS OF REFERENCE

Project: Law on Bank Guarantees
Project Owner: Constantin Barbu RBA Director (on behalf of RBA)
Project Manager: Janfred Silberstein, Director, NBR
Deputy Project Manager: Tudor Taslaoanu, Director, Alpha Bank Romania

I- Background

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.

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 domestic 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 bank guarantee contracts, an RBA group has put together the principal terms of a proposed guarantees law.

II - Project Objective

To prepare a bank guarantee law proposal that would meet the interest of the banking industry to improve the enforceability of banking contracts, supported by a legal comparison of similar laws in other EU countries and a RIA on the costs met by banks under the current practice and the possible benefits if a law is enacted.

III – Intended Strategy

The project management group (Project Owner, Project Manager, Deputy Project Manager, supported by the SPI Secretariat) acts based on the mandate received from the SPI Committee to reach the project objective.

To build on the existing RBA work on the matter and to make it adequate to initiate the formal legislative amendment process after SPI Committee endorsement, the PMG should form a project working group (PWG) with meaningful representation by authorities (Ministry of Justice, Ministry of Public Finance, and National Bank of Romania).

The project management group (PMG) should start building on the existing understanding of the problems raised by the current practice of issuing and enforcing bank letters of guarantee (LGs). In order to get acquainted with the RBA analyses and recommendations on the issue, the SPI Secretariat, on behalf of the PMG, will ask the RBA to provide the draft bank guarantee law proposal and any other relevant materials regarding the RBA work on the matter.

To help document the PWG work with the costs and risks incurred by banks in applying the current legislation, the SPI Secretariat will support the PM to:

- a. perform a survey on the practices used by banks in drafting the LGs and the problems encountered in enforcing the LGs, outlining the costs and risks generated and necessary improvements with their implied effects in terms of costs and risks for banks;
- b. prepare a RIA outlining the cost incurred by banks under the current legislative framework and the possible benefits if a law is enacted.

Also, in order to broaden the understanding of the drawbacks perceived in applying the current legislation, the PM/DPM/SPI Secretariat will ask the Romanian Chamber of Commerce to outline its experience in dealing with LGs related disputes.

The SPI Secretariat will help the PWG assess whether the RBA draft law proposal adequately addresses the concerns of the stakeholders, based on these documents and an analysis on the costs and risks raised by the current practice of issuing and enforcing LGs. The PWG members will incorporate any adjustments necessary and will prepare a document with proposals for a bank guarantee law. If necessary, the SPI Secretariat will use its best efforts to secure an independent international legal opinion on the proposed draft law.

IV- Methodology: from kick off to the accomplishment of the project

Preparation of PWG 1st meeting (PM/DPM and SPI Secretariat)- January 17 – February 2

PM/DPM/SPI Secretariat will gather existing documentation on the matter from the RBA Legal Committee.

SPI Secretariat will conduct a survey on the practices used by banks in drafting the LGs and the problems encountered in enforcing the LGs on a representative sample of banks. Based on the costs and risks as outlined by the survey, the SPI Secretariat will perform a RIA.

PM/DPM/SPI Secretariat will conduct preliminary interviews with the Romanian Chamber of Commerce and the Ministry of Justice in order to acquire an understanding of the drawbacks perceived in applying the current legislation.

PO/PM selects and appoints PWG members.

PO/PM will send to the PWG members the SPI Committee Mandate Letter together with the following documents before the PWG 1st meeting:

1. A paper prepared by the SPI Secretariat on the costs and risks raised by the current practice of issuing LGs, enforcing LGs, and solving LG-related legal disputes, outlining proposed improvements in line with international practices, based on the following contributions:

a. RBA: a package of documents gathering RBA bank guarantee law proposals and any other supporting documentation;

b. Romanian Chamber of Commerce: a presentation of its experience in dealing with LGs disputes;

c. PM/DPM/SPI Secretariat: the results of the survey, the findings of the interviews, a RIA outlining the cost incurred by banks under the current legislative framework and the possible benefits if a law is enacted, and a compilation of relevant EU laws;

2. Draft TORs prepared by SPI Secretariat and endorsed by PO and PM/DPM.

PWG 1st meeting - April

1. PWG members discuss the paper prepared by the SPI Secretariat, outlining:

a. the costs and risks incurred by banks and non-bank parties in applying the current legislation pertaining to LGs and their quantitative assessment as resulted from the RIA;

b. the present practices in solving litigations regarding LGs as described in the presentations prepared by the Romanian Chamber of Commerce and, if possible, by the Ministry of Justice

2. PWG members discuss the RBA bank guarantee law proposal and outline any other additional issues to be included in the draft regulation as resulted from the PWG discussions;

3. PWG members agree on TORs prepared by SPI Secretariat and endorsed by PO and PM/DPM;

4. PM/DPM establish **homework** for PWG members:

PWG Ministry of Justice member: review the RBA law proposal and integrate any additional necessary aspects as resulted from the PWG discussions;

PWG Ministry of Public Finance member: provide an opinion on the proposed legislative improvements.

The individual contributions will be sent to the PM/DPM and SPI Secretariat. SPI Secretariat will centralize the contributions and circulate them to PWG members before the PWG 2nd meeting.

PWG 2nd meeting - May

1 PWG members discuss and agree on the revised bank guarantee law proposal;

2. PWG members decide on the need for an independent international legal opinion;

3. PWG members agree on an outline of a paper supporting the legislative proposals to be prepared by PM/DPM/SPI Secretariat.

Homework:

SPI Secretariat: if necessary, provide an independent international legal opinion on the draft law approved by PWG members.

PM/DPM/SPI Secretariat: write the paper supporting legislative proposals.

PWG 3rd meeting - June

1. PWG members take note of the independent international legal opinion on the proposed draft law (if requested);
2. PWG members agree on any adjustments necessary based on the independent legal opinion and modify the draft law accordingly;
2. PWG members discuss and approve the paper supporting the legislative proposals.

Homework: PM/DPM/SPI Secretariat: finalize actionable SPI Committee proposal.

V- Output

PWG 1st meeting

- PWG members send individual contributions;
- PWG take note of the costs and risks incurred by banks and third parties in applying the current legislation;
- PWG members agree on possible legislative improvements starting from the RBA law proposal.

PWG 2nd meeting

- PWG members agree on the bank guarantee law proposal;
- PWG decide on the need for an independent international legal opinion;
- PWG member prepare paper supporting legislative proposals.

PWG 3rd meeting

- PWG members incorporate any adjustments resulted from international legal opinion;
- PWG members approve supporting position paper;
- SPI Secretariat sends SPI Committee Actionable Paper to Convergence.

VI - Project Team

The team is composed of:

- Banks
 - Mihaela Socol, Banca CR Firenze;
 - A. Zaharescu, BCR;
 - Mihaela Roman, HVB Țiriac;
 - Margareta Pușchiază, RZB;
 - Madalina Cristea, Unicredit.
- National Bank of Romania
 - Raluca Cristofor.
- Ministry of Public Finance
 - Dan Butoi

The team will be chaired by the Project Manager and co-chaired by the Deputy Project Manager .

PM/DPM have to report to PO at least after each meeting of the PWG.



SPI Project:
Law on bank guarantees

**Regulatory Impact Assessment
Approach Note**

Law on Bank Guarantees

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.

*= Drawn from the Project Working Group ToR

Law on Bank Guarantees

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.

*= Drawn from the Project Working Group ToR

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Law on Bank Guarantees

Economic impact assessment - 1

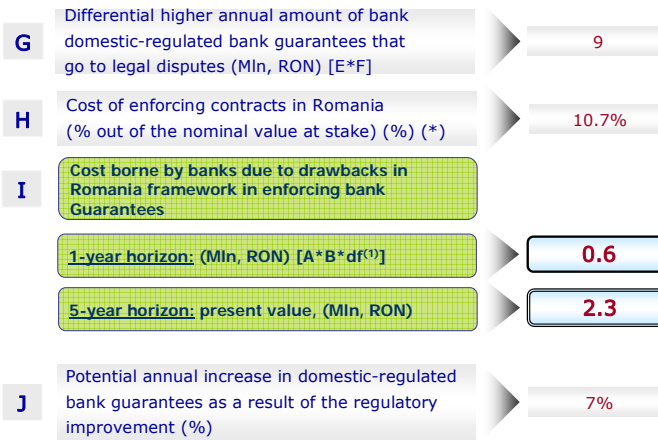
A	Banks' commitments to a natural entity or non-bank, legal entity (Mln, RON) (*)	12,887
B	Share of bank letters of guarantee (%)	20%
C	Exposure at the basis of bank letters of guarantees (Mln, RON) [A*B]	2,577
D	Domestic-regulated bank guarantees (%)	20%
E	Amount of bank letters of guarantees regulated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

(*)= Source: NBR, *Monthly Bulletin - Statistical Section*, 9/2006, p. 52

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Law on Bank Guarantees

Economic impact assessment - 2

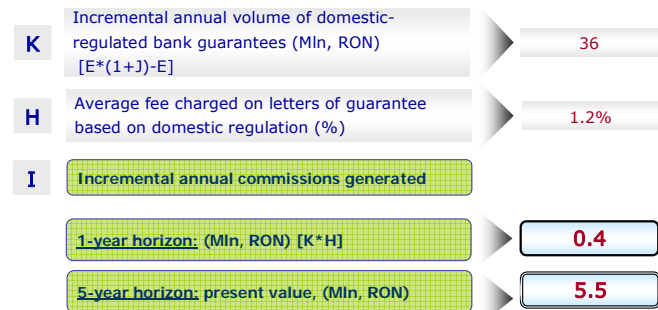


(*)= Source: The World Bank, *Doing Business – Enforcing Contracts*, www.doingbusiness.org

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Law on Bank Guarantees

Economic impact assessment - 3



(*)= Source: The World Bank, *Doing Business – Enforcing Contracts*, www.doingbusiness.org

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Law on Bank Guarantees

Analytics - 1

Commitments to a natural entity or non-bank, legal entity (Min, RON)	a)	12,887
Incidence of bank letters of guarantee (%)	b)	20%
Exposure at the basis of bank letters of guarantees (Min, 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 (Min, 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 (Min, 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 (Min, 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 (Min, RON)	k)	36
Average fee charged on letters of guarantee based on domestic regulation (%)	l)	1.2%
Incremental annual commissions generated (Min, RON)	m)=k*l	0.4

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Law on Bank Guarantees

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 based 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	

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Law on Bank Guarantees

Analytics - 3

Data and assumptions:

a) Share of LGs in total off-balance sheet exposure	20%
<i>(Based on the evidence from Annual reports of a sample of Romanian Banks)</i>	
b) Guarantees that make reference to Romanian law (%)	20%
c) Higher rate of litigation for domestic-based contracts vs foreign-based ones	1%
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%
e) Average fee charged on letters of guarantee based on domestic regulation (%)	1.2%
<i>(Based on the evidence from some Romanian Banks contracts)</i>	

SPI Project on Bank Letters of Guarantee

**Project Strategy Meeting
January 16th, 2007
Starting with 12:30
Romanian Banking Association**

Project Objective

To prepare a bank guarantee law proposal that would meet the interest of the banking industry to improve the enforceability of banking contracts, supported by a legal comparison of similar laws in other EU countries and a RIA on the costs met by banks under the current practice and the possible benefits if a law is enacted.

Project Management Group

Project Owner (PO): Constantin Barbu, Director, RBA

Project Manager (PM): Janfred Silberstein, Director, NBR

Deputy Project Manager (DPM): Tudor Taslaoanu, Director, Alphabank Romania

Attendees: Constantin Barbu (PO)
Janfred Silberstein (PM)
Tudor Taslaoanu (DPM)
Raluca Cristofor (member, NBR)
Mihaela Socol (President of RBA Legal Commission)
SPI Secretariat (Ramona Bratu, Director for Bank Products and Services)

Agenda:

1. Acknowledgement of the mandate received from SPI Committee (PO)
2. Discussion and endorsement of TORs (PMG)
3. Informing on the status of drafting the law on bank letters of guarantee in RBA (PO)
4. Discussions on the steps forward (PMG)
5. Discussions on the needed technical assistance (PMG).

1. PMG acknowledged the mandate received from the SPI Committee to prepare a proposal for a law on bank letters of guarantee. The participants outlined the need for a specific law for bank letters of guarantee, referring to:
 - international bank letters of guarantee have to be issued by the Romanian banks under a national law that can be known and accepted by the international partners (banks and companies);
 - the Romanian Commercial Code doesn't have provisions on demand bank letters of guarantee, independent from the commercial contract (as provided by the ICC Uniform Rules and Practices - Publication no.458), but only for sureties;
 - some of the decisions taken by the Romanian courts on legal disputes related to bank letters of guarantee didn't take into account the provisions of the ICC Publication no. 458 under which these were issued and, therefore, disadvantaged the banks. These decisions are building up a dangerous jurisprudence;
 - based on the existing legislations, different institutions (the customs, local administrations, ministries etc) are imposing some wordings and conditions for the required letters of guarantees (for bids, contracts etc) that could put banks in a high risk position;
 - some of the banks, for commercial reason, are accepting to issue the letters of guarantee as required by the different institutions and thus are creating a dangerous practice (clients are using as argument in asking their banks to issue the guarantees the precedents with other banks).
2. The PMG's comments and suggestions on the proposed ToRs will be sent by mail to the SPI Secretariat.
3. The RBA Settlements Technical Commission has decided to have the provisions of ICC Publication no. 458 as benchmark for the proposed law. Therefore, some of its members outlined the terms, definitions and principles foreseen by the ICC Publication that should be reflected by the Romanian law. A working group gathering members from the Settlements and Legal Technical Commissions is currently working in designing the outline of the law and the "definitions" chapter (next meeting is planned for Friday, January 19th). Once the working group will agree on the outline of the law, each member will have to contribute and propose the provisions for some chapters. The working group estimates to have the law proposal, together with a document outlining the need for a national law, by the end of February.
4. The law proposal and the document prepared by the RBA will be discussed by the SPI PWG. PWG will run a RIA in order to provide quantitative arguments for the law enactment (on a sample of banks and extrapolating the findings at the banking system level).
5. As for the technical assistance, the PMG appreciated that a specific request could be only formulated when the law will be drafted, in order to keep the law provisions in line with EU requirements. The participants outlined that there is no EU directive on bank letters of guarantee, but the ICC Uniform Rules and Practices, chosen as benchmark by the experts in documentary business from the banking community, generally enjoy the EU members' acceptance. PM mentioned that the law of an European country could also serve as a sample, although it is to be seen within the legal national context.