

# Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



## Rural Lending

### Project Objective:

To prepare a set of specific recommendations (“secondary” rules and regulations and technical and organizational implementation steps) on the measures needed to be undertaken by the competent authorities, market participants and other institutions in order to remove the existing roadblocks to the development of the agricultural warrants-backed lending within acceptable risk parameters.

## Project Working Group Activities

### PWG Members: 9

#### Public stakeholders

- National Bank of Romania
- Ministry of Agriculture
- Ministry of Public Finance
- Grading Commission
- Insurance Supervision Commission

### PWG Meetings: 2

(strategy meeting)

#### Private stakeholders

- Banking sector (2 banks)
- Guarantee Funds
- Farmers
- Depositories
- Insurance companies
- Commodities Exchange

### Project Main Steps

Jan. 07: PWG Strategy Meeting

March 07: Appointment of Project Technical Anchor (TAN) and start of his onsite work

March 07: PWG meeting to discuss on TAN’s main findings

### Summary of Impact Assessment

First full year (mln EUR)

1. Government: tax revenues\* (0.5);
2. Banks: additional loans 104
3. Borrowers: easier access to loans under better terms

\*=Levied on Banks higher net profits

### For more information, please contact:

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2. Project Management Group: Mr. Radu Negrea (Project Owner), General Secretary, RBA, tel: +40 21 321 20 78; e-mail: [radu.negrea@arb.ro](mailto:radu.negrea@arb.ro)

## **A. Project objective and deadline**

**Project objective:** To prepare a set of specific recommendations (“secondary” rules and regulations and technical and organizational implementation steps) on the measures needed to be undertaken by the competent authorities, market participants and other institutions in order to remove the existing roadblocks to the development of the agricultural warrants-backed lending within acceptable risk parameters.

**Initial deadline:** end March, 2007

## **B. Overall project status assessment and next steps**

The project has not advanced according to the initial plan due to weak involvement of the major stakeholders represented in the PWG. The PWG membership has been and will continue to be expanded in order to have both a more business-oriented composition and a better representation of all stakeholders.

The most recent PWG meeting revealed the possibility of private stakeholder actions that could accelerate the development of the warrants-deposit certificates backed lending. Banks, insurance companies, professional associations and others could join their efforts in creating a private replication of the institutions and processes whose establishment and functioning are, according to the current legal framework, dependent on government actions. This private WDC scheme could be built up around the already established National Grading Commission and on a win-win basis, ensuring the financial comfort (in terms of risks coverage) and interest of all the involved parties.

Based on the common understanding of the legal framework and using as reference TAN’s report, PWG should now be able to outline a feasible approach and viable recommendations, acceptable for all the stakeholders.

SPI Secretariat will support the PMG in developing a structured dialogue allowing the achievement of the project objective by the end of June 2007.

## **C. Actions taken so far**

### **C1. Impact Assessment**

Convergence has performed a Regulatory Impact Assessment in order to determine the annual share of annual agricultural production that could be financed against deposit certificates once the warrants-deposit certificate scheme is put in place.

The estimations show that, based on the deposit certificates, banks could register an increase in lending of EUR 559 million in a 4 years aggregated amount, with EUR 104 million in the first year.

### **C2. Project Strategy Meeting**

In the strategy meeting held on January 25<sup>th</sup>, 2007, the Project Management Group (PMG) outlined the following principles that should guide the project working group efforts in designing the recommendations:

- **a system of control of the depositaries and of the cereals deposited** should be in place to ensure that the titles issued by the depositaries (deposit certificates – warrants) are backed by cereals that are stored in the quantity and of the quality stated. This is an important trust component of the process of converting agricultural commodities into tradable securities. In practice, such system of control could be enforced through rigorous licensing procedures of depositaries, performed by a qualified institution, based on rigorous technical and financial criteria. In addition, the verification of the quality of stored cereals should be performed by independent specialized institutions.
- **a system of risk assurance** should provide comfort to those that trade or accept deposit certificates – warrants as guarantees that the risks incurred are adequately covered. In practice, this could be achieved through the setting up of the Deposit Certificated Guarantee Fund. In this regard, the Ministry of Agriculture should play a key role and could be supported by the existing Rural Credit Deposit Guarantee Fund.

Participants agreed on undertaking the following actions and tasks in order to ensure that the most relevant information is available to the working group for its deliberations enabling a rapid advance and the timely achievement of the project objective.

Participants suggested that the PWG be completed with more banks' representatives (BCR and BRD) and the Ministry of Public Finance representative joins the working group at its next meetings.

### **C3. PWG members' contributions**

**Rural Credit Deposit Guarantee Fund** prepared and shared a note containing merely the regulatory initiative needed in order to establish the indemnity fund. The **NBR** representative in the project working group sent a position note regarding the prudential treatment of the deposit certificates and the provisioning of the loans backed by warrants-deposit certificates, and some considerations on the possibility of having a rapid enforcement of the deposit certificates by law. The newly joined **Grading Commission's** representative shared with all the group members his views on gathering all the licensing, inspection, controlling and guaranteeing activities under a single roof – the Grading Commission. The newly appointed **Project Manager** presented the risk mitigation ways under RZB scheme of lending based on deposit certificates and his opinion on the indemnity fund guaranteeing the deposit certificates.

### **C4. SPI Secretariat actions**

In order to favor a common understanding of the issues, SPI Secretariat gathered and sent to PWG members a complete list of regulations on the warrants-deposit certificate, after validating it with RCGF.

In order to facilitate the understanding of the risks to be covered by the indemnity fund foreseen by the law, SPI Secretariat sent a letter to the Insurance Supervision Commission asking for details on the coverage of risks in agricultural lending by insurance companies.

SPI Secretariat took actions to enlarge the project working group composition and to give it a more business oriented feature and supported the work of a foreign expert appointed by Convergence.

## **C5. Project development interim assessment**

Given the breadth of the agenda, the SPI Secretariat and Convergence have proposed to the PO who accepted to hire an expert to put together a summary inventory of relevant issues and prepare a set of implementable recommendations. In Annex 1 we attach the ToR.

## **C6. PWG meeting on March 29**

The expert shared with the PWG the findings of his field work (Annex 2 - Minutes of the meeting).

The PWG members shared opinions on some important issues raised by TAN such as:

- *revision of the terms of the WDCs* - participants agreed that it is necessary that WDCs include all value-specific information about the grain consignment, in particular the gluten content, where relevant, in order to provide to the producers the comfort regarding the quality of the grains stored.
- *licensing of depositaries* - the issue of a compulsory versus an optional remained open but a couple of participants, including the Ministry of Agriculture, agreed that there should be a mandatory authorization of depositaries.
- *the WDC Indemnity Fund*- the indemnity fund issue has to be clarified and detailed in respect of the risks covered and of procedures, allowing thus a pertinent opinion on the opportunity of its establishing.
- *the grading system* - the grading of the grains stored with depositaries is mandatory, according to the law but the state does not ensure the enforcement of the current legal provisions.
- *the rank of the WDCs*- having the WDCs assigned with a preferential ranking would encourage banks to take on these guarantees.

Participants concluded that it would be important to discuss the issues of topical importance for the project (i.e. licensing – mandatory versus optional; supervision; indemnity fund; public sector solution versus private sector solution, etc.) in a more structured manner, based on the TAN's report, in order to allow the project completion by the end of June.

The expert will release his final report shortly.

## **D. Administrative Next Steps**

**D1: SPI Secretariat** will prepare the invitation letter to the association of depositaries to appoint a representative in the project working group (Annex 3).

**D2:** Based on TAN's report, **SPI Secretariat** will prepare a list of the main issues that have to be discussed by the project working group, outlining their pros and cons.

**D3: All project working group members** will provide feedback on the materials prepared by the SPI Secretariat on the specific topics to be addressed.

**D4: SPI Secretariat** will prepare a centralized document outlining, by issues to be addressed by the working group, the pros and cons, the opinions of the PWG members as well as the possible solutions. This document will be discussed in the next project working group meeting, to be held in May 7 -11.

In early June, PM with SPI Secretariat support will send a progress report to the SPI Committee members.

# Convergence Romania Financial Sector Modernization

## Special Projects Initiative Public-Private Steering Committee



### **Project: Rural lending (Warrants – deposit certificates)**

**Project Owner: Radu Negrea (RBA)**

**Project Manager: Marilena Popovici (Bancpost)**

**Deputy Project Manager: Aurica Stoica (Ministry of Agriculture, Forests and Rural Development)**

**Project Working Group: Rural Credit Guarantee Fund (1 expert), NBR (1 expert)**

### **Technical Anchor (TAN) Role**

#### **Project Objective:**

To provide the Project Working Group (PWG) with a thorough analysis of how bank rural lending (products, policies, processes, procedures and target clients) is done under the current regulation and how it is likely to be affected by the new regulatory solutions under consideration.

#### **Role:**

TAN will work closely with the Project Working Group and will focus on how the proposed extension of the Warrant Deposit Certificates scheme (so far largely unsuccessful) could be rolled out more successfully to stimulate rural lending.

In addition TAN will assess how other structures could be used to encourage lending institutions established in rural areas to provide more credit for the much-needed development of agriculture. This could include the development of secure warehouses in the dairy industry and egg producing sectors.

TAN will draw upon his extensive experience of Romanian banking structures and practices based on working full time inside the largest credit institution in Romania (BCR) over most of the past 2 years. TAN has already travelled widely within Romania as part of this work, although not focussed on agriculture. TAN will also be able to add his experiences of working in Macedonia for the World Bank (which included assessments of agricultural lending) as well as direct lending experience to the UK dairy industry during his banking career in the City of London.

TAN will: -

- Meet with all PWG members to gain a full understanding of the project to date

- Study all available existing documentation relevant to the project both before and during the assignment
- Meet with other relevant parties including commercial banks involved in rural lending in order to understand the current frameworks and challenges, plus the type of credit products that are used in the lending markets
- Perform an “as is” assessment of current rural lending volumes to include:
  - The approximate volumes of rural lending plus the trends over the past 5 years
  - The principal lending institutions committed to the sector plus commercial assessments of the credit products they offer
  - An assessment of the mix of lending to agricultural borrowers by segment, split by cereals, other crops, dairy, meat and poultry plus the 5 year trends
  - Bad debt experience of the lending banks plus recoveries performance (if such data is available)
  - Feedback from the bank credit officers on how things could be better
- Perform a “could be” assessment of how issues raised by the as is analysis could be improved through a streamlined warrant deposits scheme that could have the confidence of the lending institutions
- Make an assessment of any other collateral or regulatory measures that might be successful in addition to the warrant deposits
- Consider what changes might be required to bank products and lending procedures to gain best advantage from new legislation or measures
- Present his findings in a draft report to a meeting of the PWG
- Complete a Final Report one week later

**Collaboration:**

With PM/DPM/SPI Secretariat

**Reporting:**

Main: Project Manager; Secondary: SPI Secretariat.

**Estimated Number of Days:**

TAN’s assignment is expected to take up 3 weeks of field work in Bucharest/rural areas.

**Output:**

Business-implementation analysis that will be prepared and presented (findings and conclusions included) before the PWG.

# Convergence Romania Financial Sector Modernization

## Special Projects Initiative Public-Private Steering Committee



**SPI Project SPI Project on Rural Lending  
Project Working Group Meeting  
March 29<sup>th</sup>, 2007  
10:00 – 13:00  
Romanian Banking Institute**

### **Participants:**

#### *Project Management Group*

Project Owner: Radu Negrea, RBA Board Member

Project Manager: Claudiu Nicula, Manager, Raiffeisen Bank

Deputy Project Manager: Aurica Stoica, Advisor to Minister, Ministry of Agriculture

#### *Project Technical Anchor*

Les Clarke, Consultant, World Bank

#### *Project Working Group*

Veronica Toncea, President, Rural Credit Guarantee Fund

Dina Ilie, Expert, National Bank of Romania

Silviu Ioan, Romanian Credit Guarantee Fund

Vasile Coman, National Loan Guarantee Fund for SMEs

Alexandru Sorescu, Romanian Stock Exchange

Mihai Perju, Romanian Stock Exchange

Dumitru Sandulescu, Romanian Stock Exchange

Viorel Marin, National Grading Commission

Adrian Radulescu, Agricultural Producers Association

*SPI Secretariat* (Ramona Bratu, SPI Director for Bank Products and Services, Oana Nedelescu, SPI Director for Analytics and Policy)

## **MINUTES**

### **I. Brief update on the project background and project status report**

The Project Owner and the SPI Secretariat gave a brief update on the project background (SPI Committee mandate and activities; project initiative, objective and governance, etc.) and project status for the new members of the project working group (analytical work done so far and meetings held by project technical anchor and SPI Secretariat with various stakeholders).

## **II. Presentation made by the project technical anchor**

The project technical anchor made a presentation of his preliminary report (attached). The presentation outlined what has been done so far in the area of lending on the grain market, what are the barriers and how these can be avoided, as follows:

### *1. Description of existing rural lending practices in Romania*

Outlining the characteristics of the rural lending practices differentiated on medium term and short term financing.

### *2. Description of the grain market operating in Romania*

Outlining the structure of the grain market by types of operators (producers, depositaries, traders). The analysis stresses the small farmers are at disadvantage under the current system, where they sell their grains for very low prices. In particular, the small farmers could benefit from financing through WDCs as this could result in a more equitable distribution of the profits obtained from grain trading.

### *3. Outline of the (potential and actual) impact of the revised Romanian legislation on warrant deposit certificates*

The current legislation has most features in place to allow for the operating of the WDC system. However, there is some fine tuning that is needed for encouraging the use of WDCs.

### *4. Description of the Bulgarian model developed in cooperation with USAID*

Bulgaria has in place a fully operational WDS system, featuring compulsory licensing of depositaries based on financial and technical compliance, ongoing supervision of depositaries and a liquid market for WDSs.

### *5. The role of the Ministry of Agriculture*

Outlining the work done so far by the Ministry (mainly sponsoring the passing of the enabling legislation and establishing the Licensing Commission) and recommendations for a stronger involvement in promoting the WDCs system.

### *6. The role of the Rural Credit Guarantee Fund*

Stressing the current role of RCGF and calling for a clarification and acceleration of its proposed involvement in the WDC Guarantee Fund.

### *7. The role of the insurance market*

Outlining the current involvement of insurance companies in covering risks pertaining to grain storage and handling.



### *8. The role of the Romanian Grading Commission*

Stressing the current role of the RGC and the potential for a strong involvement in the WDC system. RGC is an advocate of compulsory registration and licensing of depositaries.

### *9. The role of the Romanian Commodities Exchange*

At present, the RCE does not intermediate grain deals, however efforts are being made on bilateral deals on a brokerage basis. The RCE is an important pillar of the WDC system as it will secure the market liquidity and the provision of relevant information.

### *10. What are the barriers to successful implementation of WDCs?*

The barriers are both on the banks' side and on the farmers' side. Both parties lack confidence in the current system as there is no licensing and supervision of depositaries.

### *11. How can the barriers be addressed – the public sector and the private sector approaches.*

There are two possible approaches for overcoming the current deadlock in the WDC system: a) a more active involvement of the public sector (mainly of the Ministry of Agriculture) in strengthening the current legal and institutional framework and b) a proactive stance of the private sector, where the key stakeholders (banks, insurers, farmers) could form a single entity to perform the following functions: licensing and supervision of depositaries, grain grading, provision of guarantee fund whose funding could come from a combination of Government grant, syndicated loan, equity, guarantee fees, grading and inspection fees, etc.

## **III. Issues raised by the project working group**

### *1. Revision of the terms of the WDCs*

Participants outlined the need to ensure that the titles issued by the depositaries – WDCs are backed by cereals that are stored in the quantity and of the quality stated, and that depositaries can always return the cereals in the amount and the quality noted in the receipt. This is an important trust component of the process of converting agricultural commodities into tradable securities.

Therefore, participants agree that it is necessary that WDCs include all value-specific information about the grain consignment, in particular the gluten content, where relevant. It was outlined that this kind of feature is important as it provides to the producers the comfort regarding the quality of the grains stored. However, this is not in the interest of the depositaries, which could potentially give back to producers grains of a lower quality.

### *2. Licensing of depositaries*

While the issue of a compulsory versus an optional remained open, a couple of participants, including the Ministry of Agriculture, think that there should be a mandatory authorization of depositaries. According to some participants, only the depositaries engaged in grain trading should be licensed. There are pros and cons of each option, which will be further analyzed by the project working group.

### *3. The WDC Guarantee Fund*

A system of risk assurance (i.e. indemnity fund) should provide comfort to those that entrust their crops for storage, trade or accept deposit certificates – warrants as guarantees that the risks incurred are adequately covered. It is very important that there is clarity in the risks covered by the indemnity fund. In the opinion of the bank representative, as initially conceived, the indemnity fund does not cover credit risk and covers only some legal risks (i.e. risk of fraud by depositaries). If so, the role of the indemnity fund is not critical and banks could even assume some risks, which would be ultimately reflected in the pricing of the loan.

The indemnity fund issue has to be clarified and detailed in respect of the risks covered and of procedures, allowing thus a pertinent opinion on the opportunity of its establishing.

From the producers point of view, it is very important to be able to make a comparison between the costs incurred from bank financing backed by WDCs and bank financing backed by a pledge on the stock or other collateral. Participants agreed that it would be necessary to undertake such a cost-benefit analysis.

The Romanian Stock Exchange representatives outlined that the role of the indemnity fund is very important at least at the inception of the WDC system as it could provided the necessary liquidity. In their view, the establishment of the indemnity could reduce the costs of transacting the grains through the stock exchange as the latter could give up requesting the guarantee requested for transactions. Over time, its role could be taken over by a deep and liquid market of WDCs ensured by the Romanian Stock Exchange.

National Grain Grading Commission outlined that according to some previous estimates, an investment of EUR 3.75 mil. would be necessary to set up the indemnity fund and ensure its initial operations. Likewise, it was estimated that about 50 percent of this investment could be covered in the first two years of operation only from revenues from grading taxes.

Likewise, participants concluded that they would like to deepen their understanding of the international experience with setting up the indemnity funds and the risks covered by them. This issue will be addressed in the final report of the technical anchor.

### *4. The grading system*

The grading of grains plays a very important role in ensuring the quality of the grains stored. At presents, the grading of the grains stored with depositaries is mandatory, according to the law. However, the grading is not always performed as it is either not requested by producers or offered by depositaries. Moreover, the state does not ensure the enforcement of the current legal provisions.

### *5. The rank of the WDCs*

The bank representative outlined the importance of having the WDCs assigned with a preferential ranking in order to encourage banks to take on these guarantees. The NBR representative stressed that this issue is beyond the central bank capacity to operate these changes and the matter should be further pursued with other competent authorities.

#### **IV. Next steps**

Participants concluded that it would be important to discuss the issues of topical importance for the project (i.e. licensing – mandatory versus optional; supervision; indemnity fund; public sector solution versus private sector solution, etc.) in a more structured manner. Likewise, participants stressed that it is necessary to have a better representations of banks in the working group. The following steps will be undertaken:

**1. Project Technical Anchor** will finalize the report by incorporating the suggestions received in the meeting and will send it to the project working group next week.

**2. SPI Secretariat** will prepare a list of the main issues that have to be discussed by the project working group, outlining their pros and cons, based on the material prepared by the technical anchor.

Likewise, the SPI Secretariat will contact BCR and BRD, asking them to provide experts for the project working group. At the same time, the SPI Secretariat will also ask the Ministry of Public Finance representative to join the working group at its next meetings.

The SPI Secretariat will prepare a compilation of the legislation that will be submitted to the entire project working group in order to facilitate a common understanding of the current legal framework.

**3. All project working group members** will provide feedback on the materials prepared by the SPI Secretariat on the specific topics to be addressed.

The SPI Secretariat will prepare a centralized document outlining, by issues to be addressed by the working group, the pros and cons, the opinions of the PWG members as well as the possible solutions. This document will be discussed in the next project working group meeting.

#### **V. Next project working group meeting**

The next project working group meeting could be held in the week May 7-11.

## Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



27 aprilie, 2007

**Domnului Sorin Dogaru**

**Președinte**

Asociația Patronală a Angroșiștilor de Cereale din România

Director, Departamentul de Agricultură

S.C. INTERAGRO SA

Strada Verii nr. 1-3, Sector 2

București

### *Invitație pentru participare în cadrul grupului de lucru referitor la creditarea agriculturii*

Asociația Română a Băncilor, Banca Națională a României, Ministerul Finanțelor Publice și Autoritatea națională pentru Protecția Consumatorilor au realizat, cu sprijinul Programului de Convergență administrat de Banca Mondială, un parteneriat numit Comitetul de Inițiativă pentru Proiecte Speciale (Comitetul IPS) pentru modernizarea sectorului bancar din România,

Comitetul IPS a aprobat derularea unor proiecte menite să îmbunătățească funcționarea sistemului bancar sau să dezvolte activitatea bancară, printre care un proiect al cărui obiectiv este realizarea *unui set de recomandări specifice (reguli și reglementări, precum și etape tehnice și organizatorice de implementare) privind măsurile necesare a fi luate de către autoritățile relevante, participanții de pe piață și alte instituții, pentru înlăturarea barierelor existente în calea dezvoltării finanțării agriculturii pe baza de certificate de depozit, în condiții de risc acceptabile.*

Proiectul este coordonat de către domnul Radu Negrea, din partea A.R.B., iar grupul de lucru întrunește reprezentanți ai Ministerului Agriculturii, băncilor, Băncii Naționale a României, Fondului pentru Garantarea Creditului Rural și Comisiei Naționale de Gradare.

Dorind ca toate părțile implicate în derularea tranzacțiilor pe bază de certificate de depozit să ia parte la dialog în vederea identificării unor soluții, vă invităm să vă alăturați acestei inițiative prin desemnarea unui reprezentant al instituției dumneavoastră în cadrul grupului de lucru.

Cu stimă,

Florin Georgescu  
Prim – viceguvernator  
Banca Națională a României

Radu Grațian Ghețea  
Președinte  
Asociația Română a Băncilor