



SPI Project:

Rural Lending

Regulatory Impact Assessment Approach Note

Background* - 1

In Romania, agricultural lending represents a modest share of total bank loans, estimated in July 2004 at a mere 2.6% of the total bank loans above EUR 5,000 that were extended. The high transaction costs and risks are the main factors that affect the supply of credit in rural areas. One of the drawbacks perceived by banks in rural financing is lack of clarity of the legislation regulating the use of the ownership title (warrants-deposit certificates) for agricultural products.

Initially regulated by a law from 1937, the regime of warrants - deposit certificates for crop inventories was further clarified between 2000 and 2003 in six legislative acts (Government Emergency Ordinance no. 56/2000 approved and modified by Law no. 39/2001; Government Emergency Ordinance no. 109/2000 approved by Law no. 657/2001; and Government Emergency Ordinance no. 141/2002 approved by Law no. 39/2003) and some additional methodological norms.

The main provisions of the regulatory framework are:

- the deposit certificates for crop inventories represent bearer negotiable titles, issued by depositaries in exchange of crop inventories deposited in the warehouses;
- in order to issue deposit certificates, the depositaries have to be inspected and licensed by the Ministry of Agriculture, Forests and Rural Development or an authorized inspector, based on a verification of the depositary's compliance with the requirements for storing crop inventories;

Background* - 2

- the Deposit Certificates Guarantee Fund (DCGF) is established as a public institution, in order to guarantee the reimbursement of the crop inventories value as stated in the deposit certificates. The depositaries that have been licensed have to open a deposit in the account of the DCGF in an amount representing 0.5% of the market value of the stored crop inventories for which have been issued deposit certificates. The organization and functioning of the DCGF are established by its by-law, approved by the Government following a proposal of the Ministry of Agriculture, Forests and Rural Development.

So far, the implementation of the regulatory framework yielded poor results. DCGF has only been established on paper and no deposit certificates for crop inventories have been issued. Also, according to some authorized sources, only one depositary has been licensed to issue deposit certificates.

According to other countries' experience, lending against warrants-deposit certificates on cereals has the potential to increase commercial banks' lending to agriculture, by reducing the credit risk, lowering transaction costs, and improving loan recovery.

The value of cereals that are warehoused in one year (about EUR 900 million) can give an indication of the potential of rural lending based on warrants – deposit certificates.

Economic impact assessment - 1

A	Value of crops stored every year (Mln, RON)	270
B	Average loan to value ratio (loans granted/value of crops stored) (%)	65%
C	Annual potential room for banking rural credit based on deposit certificates	
	<u>1-year horizon:</u> (Mln, RON)	175
	<u>5-year horizon:</u> present value, (Mln, RON)	717
D	Interest rate on bank loans backed by deposit certificates (%)	12%
E	Mark-up on bank loans (%)	3%

Economic impact assessment - 2

F

Interest rate charged on bank loans backed by deposit certificates

1-year horizon: (MIn, RON)

21

5-year horizon: present value (MIn, RON)

86

G

Mark-up on bank loans

1-year horizon: (MIn, RON)

5

5-year horizon: present value (MIn, RON)

21

Analytics - 1

value of cereals that are warehoused in 1 year (*) (Mln, RON)	a)	270
Average loan to value ratio (loans granted/value of deposit certificates) (%)	b)	65%
Potential room for annual banking rural credit based on deposit certificates (Mln, RON)	c)=a*b	175.5
Interest rate charged on bank loans backed by deposit certificates (%)	d)	12.0%
Interest rate charged on bank loans backed by deposit certificates (Mln, RON)	e)=c*d	21.06
Mark-up on bank loans (%)	f)	3%
Annual mark-up stemming from potential larger banking rural credit (Mln, RON)	g)=e*f	5.3

		2007	2008	2009	2010	2011	
Potential room for annual banking rural credit based on deposit certificates (Mln, RON)	1)	176	176	176	176	176	
Interest rate charged on bank loans backed by deposit certificates (%)	2)	21	21	21	21	21	
Mark-up on bank loans (%)	3)	3.0%	3.0%	3.0%	3.0%	3.0%	
PV - Potential rural banking lending (Mln, RON)		163.9	153.0	142.9	133.4	124.5	717.7
PV - Potential interest rate on rural lending (Mln, RON)		19.7	18.4	17.1	16.0	14.9	86.1
PV - Potential mark up from rural lending (Mln, RON)		4.9	4.6	4.3	4.0	3.7	21.5

5-years

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

Analytics - 2

Data and assumptions:

a) Average length of bank loans backed by deposit certificates: 1 year

b) Lending rate: 12%

c) Mark up of a bank loan: 4%

d) Estimate of the value of crops stored every year:

i) Number of crop farms(7,700

ii) Average size of a crop farm (hectares)(**) 270

iii) Value of agricultural output per ha (Eur)(**) 248

iv) Percentage of the the total value stored (%) 20%

v) Total value of crops stored every year (Mln, EUR)

(Mln, EUR) **103**

(Mln, RON) **363**

Conservative assumption (Mln, RON) **270**

e) Average loan to value ratio (loans granted/value of deposit certificates) (%) 65%

f) All loans will be granted in RON

(*)= The World Bank, *Financial Markets, credit constraints and investment in Rural Romania*, April 2001.

(**)=FAO-IBRD, *Romania: bank lending to SMEs in rural area*