

Convergence Romania Financial Sector Modernization

Special Projects Initiative Public-Private Steering Committee



**SPI Project SPI Project on Rural Lending
Project Working Group Meeting
March 29th, 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, Convergence Program

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.