

Special Study

**Grain Receipts Programme
(Regional)**

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Project Evaluation
Department



European Bank
for Reconstruction and Development

SPECIAL STUDY
WAREHOUSE RECEIPTS PROGRAMME /
AGRICULTURAL COMMODITY FINANCING PROGRAMME

PREFACE

The subject of this special study is the Warehouse Receipts Programme (WHRP) which, since January 2004, has been referred to as the Agricultural Commodity Financing Programme (ACFP). The WHRP is a private sector regional investment operation, which involves short term renewable Bank loans primarily to traders and processors of agricultural products in different countries of operations. The loans are intended for the temporary storage of agricultural commodities.

This study was written by Paul-Henri Forestier, Senior Evaluation Manager. Peter Bryde, Senior Banker, Agribusiness, Team Leader for the Programme, Ilir Fani, Principal Banker and Nick Papandreou, Deputy Portfolio Manager provided valuable support and information for this study.

The Operation Team and other relevant Bank staff commented on an early draft of this study and the Secretary General was consulted on the final draft.

Information about the WHRP was obtained from relevant teams and departments in the Bank, its files as well as from external sector and industry sources. Visits, interviews and attendance at international conferences were carried out between April and June 2004 in Ukraine, Bulgaria and Holland. In addition, fieldwork which took place in Russia in 2003 was extensively used for the purpose of this study. The Project Evaluation Department (PED) would like to take this opportunity to thank those who contributed to the production of this study.

The post evaluation selection process

The projects evaluated in this special study were selected using the following criteria:

- relevance to the Bank's likely future operations
- lessons learned potential
- size of the Bank's investment commitment/exposure
- balance among countries of operations
- balance among sectors and types of operations, and
- the relative priority of the special study within PED's overall work programme priorities and resources

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ABBREVIATIONS

ACFP	Agricultural Commodity Financing Programme
ATF	Almaty Trade Finance Bank
BIS	Bank for International Settlements
EU 15	the 15 members states of the European Union in the period prior to enlargement in 2004, namely Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom
IRB	Internal Rating Based
LGD	loss given default
Libor	London Interbank Offered Rate
OpsCom	Operations Committee
PD	probability of default
PED	Project Evaluation Department
P/L	profit and loss
RAROC	risk adjusted return on capital
RCE	Regional Commodity Exchange
ROA	Return on assets
SME	small and medium sized enterprises
TC	technical cooperation
USAID	US Agency for International Development
US\$	United States dollar
WHR	warehouse receipts
WHRP	Warehouse Receipts Programme

DEFINED TERMS

EBRD, the Bank Board	European Bank for Reconstruction and Development (EBRD)
the Operation Team	EBRD's board of directors the staff in the Banking Department and other respective departments within the Bank responsible for the operation appraisal, negotiation and monitoring
PED	staff of the Project Evaluation Department who carried out the evaluation

Special Study

Warehouse Receipts Programme

INTRODUCTION

The term Warehouse Receipts Programme embodies the Agribusiness Team's overall financing activity against agricultural commodities, whether or not such credits are secured by a pledge of warehouse receipts (WHR). WHR allow agricultural producers and processors to obtain working capital by using agricultural products stored in licensed warehouses as collateral. In countries where legal and regulatory provisions applicable to WHR are satisfactory to the Bank, such financings may include a degree of domestic operating risk. In all other situations, when WHR legislation is either non-existent or inadequate, the underlying rationale has usually been to promote this instrument and to strive to move legal transition forward through policy dialogue and technical assistance. Acknowledging this shift in the scope of the programme, the Agribusiness Team renamed the WHP the Agricultural Commodity Financing Programme (ACFP) when updating the Board of the EBRD in January 2004.

Under PED's 2004 work programme, a review of this Programme was undertaken. This review encompasses the broader definition of the ACFP, bearing in mind that the justification for such an activity is the utilisation or the promotion of WHRs which are central to this special study. It should be noted that transactions or sub-projects approved under a Framework do not encompass all operations that would qualify as agricultural commodity financing. The larger transactions are approved on an ad hoc basis, outside of the Framework and are included in the scope of this study. In reviewing and evaluating the ACFP, PED considered short term achievements and the longer term potential of the Bank's efforts in promoting WHR as instruments for an existing or future lending technique from a transition impact standpoint. Transition impact refers to the Bank's ability to contribute to the transition to market economies. With respect to the Bank's agricultural commodity based portfolio, PED considered and evaluated its progression, diversification, risk and return to the Bank as well as the Bank's additionality in its building process. In this context, the term additionality indicates that the Bank complements rather than displaces private sector finance and it does not finance projects that can be funded on equivalent terms by the private sector. This study looks at the lessons learned from the Bank's achievements and makes recommendations for future activity. Broader considerations regarding primary agriculture developments are outside the scope of this study.

EXECUTIVE SUMMARY

The Agricultural Commodity Financing Programme (ACFP) is geared toward financing traders and processors of agricultural commodities such as grain, seeds or sugar. Although it provides liquidity to the primary sector, the ACFP currently has a limited impact on farmers. Indeed, taking advantage of warehousing requires volumes, logistics and some degree of financial sophistication that is only found among very large farmers or farm cooperatives.

PED's review of the ACFP's fundamentals indicates that it delivered the transition impact expected from greater transparency, increased competitiveness and the provision of liquidity to the primary agricultural sector. The ACFP's longer term potential is also significant as warehouse receipts (WHR) legislation should contribute to the creation of regional agricultural commodity exchanges that require onset delivery points and grade certification, which are integral to the institutionalisation of a WHRP. In addition, banks eligible for the Basel II (Revised International Capital Framework of the Bank for International Settlements) advanced internal rating based (IRB) approach will find it relatively more attractive to lend against WHR from a regulatory capital standpoint. In promoting this programme the Bank has demonstrated and continues to demonstrate a very high level of additionality. PED observed, however, that such additionality would be less evenly distributed if rated at the individual transaction level.

Two important aspects of the Bank's sponsored ACFP are discussed in this special study and give rise to important recommendations:

- WHR are designed to provide a level of comfort from a credit standpoint since the creditor/holder of such a document should be able to secure, release and liquidate the financed goods on demand, thereby avoiding any court procedures. Such out of court enforcement procedures are, however, possibly open to legal challenge. Although this is an unlikely situation, it has not yet been tested and expert local legal advice should help to mitigate this risk.
- Indemnity funds are intended to cover non-insurable fraud risk. Unfortunately, these have proven difficult to set up and, since no claim has yet been made against the few existing indemnity funds, this is also an untested area.

A detailed review of the portfolio's risk profile and profitability indicates that, based on a risk adjusted return on assets, the ACFP appears to score very well. Unfortunately, available financial information on the portfolio remains somewhat approximate and comparative performance analyses with other bank sector activities have not been undertaken.

The Agribusiness Team has so far demonstrated an immaculate credit track record on a fast expanding portfolio of short term transactions. The promotion of the ACFP in many countries of operation has considerably enhanced the Bank's visibility as was independently verified by PED.

PED's overall rating of the ACFP was *Highly Successful*.

I. PROGRAMME DESCRIPTION

As mentioned in the introduction, the Agribusiness Team updated the EBRD Board in January 2004 on its strategy regarding the ACFP. This section is based on the material presented to the Board in January 2004, which essentially covers the period 2000 to November 2003. The Bank's portfolio analysis, under Section V below, is, in contrast, based on more recent data.

A. SECTOR ANALYSIS

The greatest potential for agricultural commodity lending is in countries which are major producers of agricultural commodities, such as grain, sugar or sunflower seeds, or net exporters of these commodities. In many countries the agriculture sector has experienced significant changes over the last few years. The most significant recent trends are summarised below.

- 1) There has been a steady recovery in agricultural production in many of the Bank's countries of operation. Some of them, most notably Russia and Kazakhstan, benefiting from an improved macroeconomic situation, political stability and favourable weather conditions, achieved a robust increase in grain production and became net exporters on the world grain market. The tables below demonstrate the significant increase in production and exports of main agricultural commodities in the region between 2000 and 2002.¹

Table 2. Agricultural commodity production

Country (million metric tons)	Grain			Oilseeds		
	2000	2001	2002	2000	2001	2002
Russia	61.9	82.4	84.3	4.4	3.2	4.1
Ukraine	23.2	38.4	37.7	3.7	2.5	3.5
Romania	10.4	15.2	12.7	1.0	0.9	1.1
Kazakhstan	11.3	15.7	15.6	0.3	0.4	0.4
Estonia	0.7	0.5	0.5	-	-	-
Serbia and Montenegro	5.1	8.9	8.0	0.4	0.5	0.5
Croatia	3.1	3.1	3.6	0.1	0.1	0.2
Poland	22.3	27.0	26.9	1.0	1.1	1.0
Bulgaria	4.3	4.8	5.5	0.4	0.4	0.5
Slovak Republic	2.2	3.5	3.1	0.3	0.4	0.4
Moldova	1.9	2.5	2.7	0.3	0.3	0.3
Total	146.4	202.0	200.6	11.9	9.8	12.0

Source: USDA.

Table 3. Gross agricultural commodity exports²

Country (1,000 metric tons)	Grain			Oilseeds		
	2000	2001	2002	2000	2001	2002
Russia	1,282	6,972	16,100	799	74	245
Ukraine	1,526	8,976	12,030	1,105	151	466
Romania	278	1,169	650	158	162	220
Kazakhstan	3,995	4,186	6,005	5	11	10
Serbia and Montenegro	70	269	450	10	25	25
Croatia	242	312	450	5	5	5
Poland	10	44	621	34	292	40
Bulgaria	708	1,072	1,500	70	75	165
Slovak Republic	30	275	100	75	143	145
Moldova	125	168	155	95	98	100
Total	8,266	23,443	38,061	2,356	1,036	1,421

Source: USDA.

¹ It should be noted that 2003 was a bad year in terms of agricultural commodity production for most countries throughout the Bank's countries of operation. Only Kazakhstan was expected to be a net exporter of agricultural commodities.

² Gross exports numbers do not take into account gross imports of agricultural commodities.

The recovery in agricultural production has several important implications for the sector in the respective countries.

- 2) As more grain and other agricultural commodities become available for export, more traders, including international companies, enter the local market, which raises the demand for working capital/pre-export commodity financing. Although some local banks and traders have started injecting liquidity into the agricultural commodity sector, the supply of financing continues to fall short of demand. The Bank has an important role to play in mobilising financing in some of its countries of operations. It participates either as an arranger or funded/unfunded risk participant in the commodity backed facilities, thereby increasing the liquidity in the agribusiness sector in the countries where the Bank is active.
- 3) Restructuring in the primary agricultural sector has in general been slow and in some countries has barely started. Although it should be noted that in several countries including Russia, Ukraine and Kazakhstan changes are taking place. An increasing number of agribusiness companies (traders and processors of agricultural commodities) in these countries reportedly have solid business strategies, necessary financial resources, management strength and adequate corporate governance practices.
- 4) There have been large differences in the speed with which different governments adopt and implement WHR legislation.³ Whereas some countries including the Slovak Republic, Bulgaria, Kazakhstan and Lithuania have been reasonably quick in adopting and implementing WHR legislation, a number of countries including Poland and Russia are taking longer. In the absence of WHR legislation and supporting infrastructure including, for example, licensed warehouses, regular inspections and indemnity funds in some countries, market participants have developed alternative commodity financing credit enhancement mechanisms. In Russia, for example, the banks have either deployed an inhouse collateral security service or hired reputable private surveyors to control pledged grain in silos. Although such systems temporarily fill the institutional gap, they are costly and accessible only to a limited number of large traders and processors.
- 5) To overcome imperfections of the collateral enforcement procedures, banks in some countries have also developed innovative forms of financing including repo financing, based on the ownership of commodities. In 2004 the Bank participated for the fifth consecutive year in this type of financing in Russia. This facility was expanded to include imports from Kazakhstan in August 2003 and the Board recently approved a further extension of its scope to include Ukraine and to increase the Bank's total commitment to US\$ 200 million from US\$ 140 million.
- 6) The increase in trading activity puts increased pressure on supporting infrastructure including ports, storage and handling facilities, roads and vessels. This has recently become one of the main constraining factors in the realisation of the growing grain export potential in some of the Bank's countries of operation including Russia, Ukraine, Kazakhstan and Romania. Many traders and vertically integrated agribusiness companies are currently investing or considering investing in logistics assets which support their trading activities in the region.

³ This is further developed in section II below.

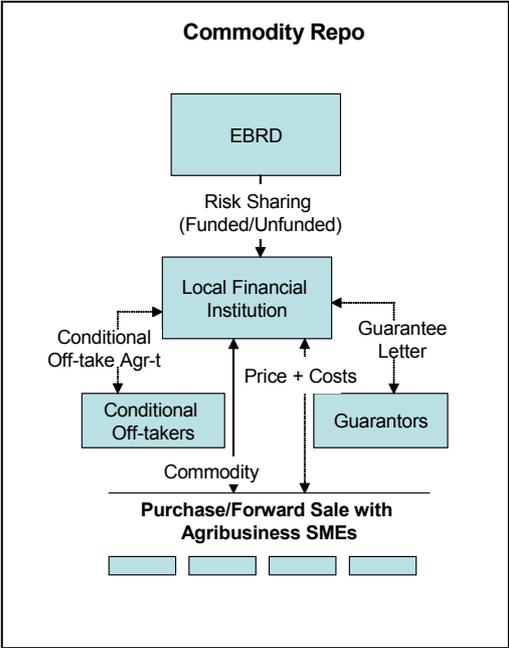
B. STRUCTURES WITHIN THE PROGRAMME

Since 2000, when the Framework, was first approved, the Bank has been working on the development of financing structures that reflect market needs and realities in the agribusiness sector in individual countries. The form of the Bank’s participation is based on a combination of factors, including the existence of adequate WHR legislation or, failing this, easy enforcement procedures for pledges over soft commodities, institutional environment and the availability of creditworthy counterparts which determine the way in which funds are channelled to the ultimate borrowers. Outlined below are three of the currently most used structures, the first two structures involve local financial institutions and the last structure involves local traders/processors. Five other possible structures which have been implemented or contemplated by the Agribusiness Team are described in Appendix 2.

1) Risk participation in commodity repo financing

Under this scheme, which was successfully used by the Bank for the fifth consecutive year in 2004, the local financial institution,⁴ purchases commodities from the agribusiness processor and/or trading company and, at the same time, sells forward the same or processed commodities. The financing is secured by the legal ownership of the commodities, which mitigates the risk of enforcing the security, which is imminent in any kind of standard collateralised lending in countries lacking properly functioning WHR legislation. Risk is further mitigated in this structure through:

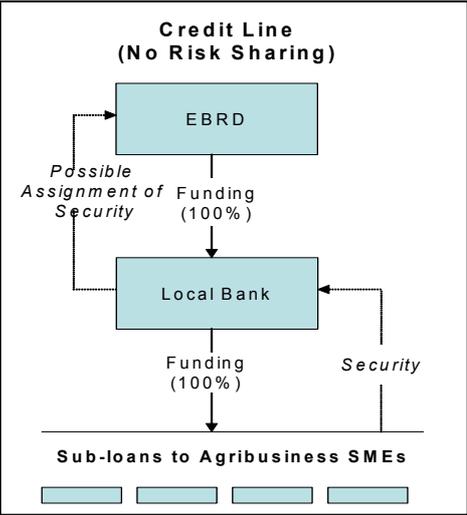
- (i) agreements with conditional off takers and foreign guarantors in case of default by the main borrower
- (ii) surveillance of commodities stored at acceptable warehouses by professional surveyors, and
- (iii) insurance of the commodities stored. The Bank’s participation in this structure is that of a risk participant, which can be funded and/or unfunded.



⁴ The local financial institution may be a non-bank ad hoc subsidiary of a financial institution or bank.

2) Credit line to a local bank for on lending to local agribusiness companies which is secured by commodities

In this structure the local bank is responsible for the provision of financing to local agribusiness entities in accordance with pre-agreed criteria. This structure comprises various measures to mitigate the risks associated with commodity backed financing, until the WHR law is approved and the institutional framework is established. The Bank will usually have an assignment of the security, namely sub-loans and WHR. This structure has been utilised in several countries including Bulgaria, Ukraine and Kazakhstan. In order to achieve its objectives, in some countries the Bank has also arranged technical assistance to train local bank staff.



3) Loan to a local trader/processor with limited recourse to a sponsor

This structure is very similar to the one above with the main difference being that the Bank receives a guarantee from a sponsor, usually the borrower’s parent company. The sponsor’s guarantee may be carved out for certain political events such as war, expropriation and prohibition of exports. Subject to special provisions in the agreement in case the specified political event occurs, the sponsor’s guarantee may be released only after the legal title on commodities with market value sufficient to repay the loan has been effectively transferred to the Bank. As this structure relies heavily on the sponsor’s full commercial guarantee, it is appropriate for countries where the WHR law either does not exist or is not yet operational.

The above list and the other structures described in Appendix 2 do not exhaust all possible financing structures and, indeed, contemplate some combinations which are yet to be implemented. It is interesting to note that few currently active transactions rely on WHR as the ultimate security backing up the credit extension. This is due to the fact that not many countries have fully implemented the necessary legislation that would be acceptable to banks or because the legislation is still at too early a stage of implementation to be entirely reliable. It is, however, important to underline that, in every case, the Bank’s rationale in developing this activity is to promote the introduction of WHR legislation. To date the Bank has met with mixed success as will be seen later. When and where the relevant legislation is implemented the Bank’s financing structure evolves toward less third party recourse and greater reliance on domestic security. Furthermore, WHR legislation paves the way for increased participation by the commercial financial sector which explains why, in some cases, the Bank becomes redundant in a market it was instrumental in creating.

C. THE EBRD'S PORTFOLIO UNDER THE ACFP

The Bank's commitments under the ACFP have grown substantially since the first transactions were initiated in 1998. From a few facilities processed through local banks with a strong hold on the domestic agricultural sector in central Europe, the team developed a far more diversified portfolio involving a number of international traders moving eastward, notably in Ukraine, Russia and Kazakhstan, and implementing an increasingly structured approach. Section V of this report provides an analysis of the Bank's portfolio. Presently 13 transactions are active, for an aggregate commitment of approximately US\$ 435 million which was forecast to exceed US\$ 500 million by year end 2004. They cover seven countries of operation - Croatia, Kazakhstan, Moldova, Romania, Russia, Serbia and Montenegro and Ukraine but the Bank has been active in other countries where its additionality is no longer verified, to a large extent as a result of the success achieved by the ACFP.

Two unrelated but important features of the portfolio should be highlighted:

- In the first half of 2004 an operation in Russia represented 39 per cent of the Programme's aggregate commitments and 60 per cent of its average operating assets with an estimated net contribution of approximately 70 per cent of the portfolio's estimated net contribution. This successful operation was recently increased from US\$ 140 million to US\$ 200 million and will be extended to cover Ukraine.
- Genuine WHR operating risk transactions have only been booked lately and there are two investments outstanding. The aggregate average operating assets are US\$ 32.8 million or 9 per cent of the total ACFP portfolio.

II. PROGRESS ACHIEVED IN PROMOTING WAREHOUSE RECEIPTS

This section examines the main requirements for an adequate functioning of WHR based financing and the current status of existing legislation and administrative regulations related to agricultural commodity financing in the Bank's countries of operations. .

A. MAIN REQUIREMENTS OF WAREHOUSE RECEIPTS

Warehouse Receipts can only become a sustainable way to finance working capital if three key elements are in place:

- a) **A WHR specific law.** Specific legislation is needed to ensure the easy enforceability of the security (i.e. a few days after the default, without court intervention) and, thereby, make WHR good collateral. The law should clearly define the rights and obligations of all parties including producers, creditors and warehouses, and it should establish a mechanism to register the financing secured by the receipts. The creditor should be in a position to unequivocally claim its right on the collateral, as it will automatically have a first ranking lien on the collateral.
- b) **Adequate licensing, inspection, and insurance of the warehouses.** The government must ensure that the licensed warehouses meet certain minimum standards and are properly inspected on a regular basis. This would ultimately enable the participants to treat all WHR equally, regardless of the warehouse that has issued them. Warehouse and stored commodities must be insured by competent insurers.

- c) **A performance guarantee system.** An indemnity fund is needed to cover the risk of potential fraud or negligent behaviour by the licensed warehouse. As the indemnity fund will only be funded over a period of time by fees collected from the depositors, the use of public funds is needed to provide a minimum initial capital.

The overall agricultural policy also affects the use of warehouse receipts. The bigger the manipulation of market prices, the less incentive there is to store and, thus, to finance the storage. If financing to agriculture is subsidised, financing WHR can only be competitive if it also benefits from some sort of subsidy.

The out of court enforceability of warehouse receipts is regarded as a fundamental issue. It requires specific WHR legislation but it would not exonerate lenders from exercising proper diligence in the documentation of loans collateralised by WHR.⁵

The establishment of a government agency in charge of setting standards and enforcing good practice through regular inspections of the warehouses is, generally, considered a necessary step to make the system effective. The Bank has, however, been involved in transactions in which warehouses were selected on their own merits and monitoring of the warehouses and the stored commodities was carried out by private collateral managers.

In every circumstance appropriate insurance is a must. The additional requirement for an indemnity fund stems from the unavailability of cover for fraud and gross negligence. Obtaining an initial contribution to capitalise such funds adequately from host governments is, however, a challenge.

B. RECENT DEVELOPMENTS

In many countries of operation with a significant agricultural sector, the Bank has played a major role in talking governments into introducing the necessary legislation and involving them in the policing of warehouses, including the creation and, in some cases, initial funding of indemnity funds. The outcome of such efforts has, however, been uneven.

In some countries it was easier to convince the administration to introduce necessary reforms because similar legislation or practices had existed prior to their inclusion in the sphere of influence of the former Soviet Union or due to their eagerness to improve the availability of bank financing to this sector or to use the ACP as a convenient channel for agricultural intervention/subsidies. In these countries the rationale for introducing reforms was somewhat different from the Bank's.

In other countries, governments failed to be convinced that such a complicated new structure would deliver much improvement to a sector that was capable of raising funds in a more traditional fashion or through ad hoc mechanisms satisfactory to banks, including the EBRD. In general though, failure to progress WHR legislation is often attributable to administrative slowness in the preparation of legislation, political haggling in the respective legislatures or delays in implementation of warehouse licensing and monitoring. The most common hindrance

⁵ For a more elaborate discussion of the benefits of WHR as loan collateral, please refer to Appendix 1, a presentation by Nicholas Budd, Partner, White & Case, (28 November 1994), *A brief description of the field warehouse pledge as an appropriate security device for developing countries and the new market economies*.

to a satisfactory implementation of the ACFP is the reluctance of governments to contribute to the initial equity requirements of an indemnity fund. As a budgetary incentive the Bank has suggested that, rather than a permanent investment, funding the initial equity requirements of an indemnity fund could be achieved through a long term interest free loan that would be repaid when user's fees have amounted over time to a level sufficient to capitalise the fund adequately.

An exhaustive review of the stages of development of WHRPs throughout the Bank's countries of operation was prepared by the Agribusiness Team for the purpose of its presentation to the Board in January 2004 and is attached to this study in Appendix 3. The summary provided below

is based on a broad classification of the different countries according to the progress recorded so far.⁶

- a) **No proper legislation in place:** Croatia is an example of a country in which legislation has been bogged down and where little progress has been achieved. The most significant situation is that of Russia, a prime target of the Bank, where efforts to introduce new legislation have not been successful. The Bank's largest exposure in agricultural commodity financing is, nevertheless, in Russia where a repo financing scheme has been developed.⁷ This has proved to be very effective and involves a private mechanism for the selection and monitoring of eligible warehouses. While a lucrative business for the banks, it is expensive for borrowers and limited to the more creditworthy end of the market. It therefore remains a Bank objective to move transition forward through policy dialogue which will lead to the introduction of proper WHR legislation.
- b) **Legislation being implemented:** Among the countries currently implementing WHR legislation, the EBRD was instrumental in providing assistance, including technical cooperation (TC) funding, to Ukraine and Moldova. In Ukraine, the first law was approved in 2002, but out of court enforcement procedures have yet to be developed in secondary legislation. Recent indications point to possible government funding of the indemnity fund. Notably, the Central Bank of Ukraine has already upgraded the rating of bank loans backed by WHR.

In Moldova, a comprehensive draft law has been prepared and was to be enacted prior to the end of 2004, this is however still pending⁸ The establishment of an indemnity fund remains an open issue. In Romania, with less active involvement from the Bank, a WHR law was ratified in 2003 and the existing enforcement procedures are expected to be effective. It will take time before warehouses are actually brought under a government licensing and controlling agency. This should not, however, preclude selective Bank financing which will initially be provided on the basis of privately monitored warehouses.

- c) **Legislation in place:** A number of countries of operation have enacted some WHR legislation. All EBRD criteria have only been implemented in a few countries including Bulgaria, the Czech Republic, Hungary, Kazakhstan, Lithuania, Poland and the Slovak Republic. The Bank had the greatest level of involvement in Bulgaria, Kazakhstan, Lithuania and the Slovak Republic. Only Bulgaria and Kazakhstan have satisfactory

⁶ This summary takes into consideration new events which may have taken place since the preparation of the document shown in Appendix 3. For this reason there are a few discrepancies with the appended text.

⁷ See above Financing Structure 1, page 4. (Please check the page number in the final formatted version.)

⁸ The text of this draft law is provided in Appendix 4.

legislation and an adequately funded indemnity fund.⁹ The Bank has remained an active lender against agricultural commodities in only two countries, Bulgaria and Kazakhstan. This indicates that implementation of WHR legislation significantly helps attract commercial lending, particularly when political risk is not a deterrent. Kazakhstan deserves a special mention for its speedy implementation of WHR legislation and establishment of an indemnity fund. The latter was made easier by the club nature of the members of the indemnity fund, which are made up of the 15 largest elevators in the country.

III. TRANSITION IMPACT ANALYSIS

A. SHORT TERM IMPLICATIONS

In the Bank's *Transition Report 2002: Agricultural and rural transition*, a description of WHR was provided, along with an explanation of the basic benefits to the sector in economic and transition impact terms.¹⁰ It can be inferred from this document that the primary agricultural sector should directly benefit from the implementation of WHRPs. While there is significant potential in this respect, such a view may be over generous in the short term.

At the present stage of WHR development and utilisation by banks, the primary beneficiaries through increased bank financing, are traders and processors of agricultural commodities who are better able to secure financing for their purchase and storage of grain, sugar and seeds for further trading or processing. Such financing is of a short term nature and, while there is an indirect benefit to the primary agricultural sector through the increased liquidity available to farmers at harvest time, the immediate economic benefit of these programmes accrues to the buyers of the commodities. The implementation of WHRPs has an impact on the transition to open market economies in terms of transparency, competitiveness and increased liquidity channelled to higher risk areas.

- a) **Transparency:** Storing grain or other agricultural commodities in a licensed and, therefore, regulated or privately strictly monitored warehouse which issues recognised receipts implies that there will be independent weighing and quality testing or grading of the commodity. This is carried out by a third party, since the warehouse is neither a buyer nor a seller of the commodity, and it is done professionally. These standards are part of the licensing requirements and would be regularly checked by a collateral manager. At the point and time of delivery of their products farmers may, therefore, obtain undisputable evidence of the value of stored commodities. This is a vast improvement over situations where transactions are typically concluded directly between a large buyer and a financially weak seller in the absence of an independent appraisal of the commodity traded. The full benefits of transparency will only accrue to farmers who are in a position to deliver directly to the warehouse. This requires a network of warehouses which is large enough to be accessible to the farmers and sufficient tonnage to deliver to justify transportation and handling charges.
- b) **Competitiveness:** A corollary of transparency is an improved competitive environment as a result of the dissemination of knowledge. Access to licensed warehouses makes it easier for buyers and sellers to choose their counterparty. Farmers and grain collectors,

⁹ The Bulgarian government, however, repatriated its initial contribution after having let users' contributions accumulate to an almost acceptable level. No call has so far been made on the fund.

¹⁰ The relevant section of the *Transition Report* is attached in Appendix 5.

on the one hand, have a safe storage space which provides independent evidence of the value of the goods stored as well as, in most cases, transferable documents which establish title to the goods. Buyers, on the other hand, have easier access to financing on the basis of WHR whether the commodities are acquired directly from the producers and shipped to the warehouse or acquired through the transfer of warehouse receipts. The benefits of increased competitiveness will only be felt over time in countries which have an operating WHRP and where banks are comfortable with credit extension on this basis. Farmers or primary collectors have the most to gain from the gradual rebalancing of their bargaining power.

- c) **Increased liquidity:** In the Bank's experience the introduction of proper WHR legislation has resulted in more significant credit extensions for finance agricultural commodities. Examples of annual lending of US\$ 50 million in the Slovak Republic, US\$ 60 million in Bulgaria and well above US\$ 100 million in Kazakhstan were quoted at two recent conferences.¹¹ Other financing structures could be used and would also result in increased liquidity for the purpose of financing agricultural commodities. They would, however, be entirely based on the credit strength of an off taker carrying the full creditworthiness of its western parent. The comparative advantage of WHR financing is its ability to delineate a risk sharing structure whereby an acceptable operating risk is taken by the banks or the traders while the latter assumes the market risk,¹² and banks provide a political risk umbrella. The EBRD's preferred creditor status would make this easier in poorly rated countries where the Bank syndicates out to other lenders. The implementation of specific legislation in countries such as Ukraine or Moldova, which reduces the operating risk of holding and storing commodities and provides for transferable title instruments with straight forward out of court enforcement procedures, therefore, contributes significantly to attracting additional financing where banks may otherwise be reluctant to lend. The transition impact of WHR, through a new institutional framework ought to be particularly felt in early transition countries.

B. LONGER TERM IMPLICATIONS

WHR implementation has far reaching implications for the modernisation of trade and related financing mechanisms. By providing a reliable delivery point and negotiable title documents, it lays the foundation for futures markets in the commodities and regions concerned. As a recognised and easily enforceable security, it will benefit from favourable treatment under Basel II and, therefore, banks will be able to improve their returns on regulatory capital through lending against WHR. This is illustrated by the potential for a grain futures market in the Black Sea Basin and by recent decisions of the Basel II committee regarding WHR.

- a) **Futures in the Black Sea Market:** Under the auspices of the United States Department of State and with funding from the US Agency for International Development (USAID), a project titled the Regional Commodity Exchange (RCE) was initiated in the late summer of 2002. One of the primary focuses of the project was the development of a marketing tool for the grain sector that will lessen price risks through tools such as futures contracts. It was identified that the Black Sea Basin region would qualify in many respects for the establishment of such a market.

¹¹ *Successful models in Implementation of warehouse receipt systems and their role in the improvement of the soft commodities market in CEE and Black Sea Basin*, (25 May, 2004), Sofia, and *Warehouse Receipt Financing*, (30 June 2004), Rotterdam. Presentations by Peter Bryde, EBRD.

¹² This could be mitigated to a large extent through the availability of future cover if and when available.

In particular, its overall population exceeds that of the United States, it has a normal production of wheat that is double the normal production of the United States and exceeds that of the EU 15. Exports in 2002 were double those of the EU and exceeded those of the United States. A number of other features which are beyond the scope of this special study confirmed the feasibility of such a project. It is possible to envisage several delivery points for physicals, including the Don River and the mouth of the Danube. The actual place of the exchange has not yet been determined, although Budapest's stock exchange appears to have an infrastructure which will, at least initially, be able to carry out such trades. As was the case with the Chicago Board of Trade, the certification of warehouses as delivery points and their issuing of recognised receipts is crucial to the development of this market. While other conditions will need to be fulfilled for the RCE to exist, WHR legislation and implementation throughout the Black Sea Basin region should contribute significantly to the creation of a futures market. This would be a step forward in institutional development for a number of countries in the region and it would further facilitate the financing of agricultural commodities by providing banks with market hedging which is, so far, only available through one to one transactions with credit worthy international traders.

- b) **BIS II implications:** Under the proposed new Capital Adequacy requirements of the Bank for International Settlements (BIS) II committee, banks opting for the Internal Rating Based (IRB) Advanced approach will have greater flexibility to compensate the high probability of default (PD) inherent in transactions with typically highly leveraged traders with a self assessed low loss given default (LGD) based on the quality of the security. This is an exception, specific to commodity and trade financing, to rules which generally apply to specialised lending. The implication is that those banks which qualify for the IRB Advanced approach will be able to finance commodity and trade with more attractive conditions without jeopardising their risk adjusted return on capital (RAROC),¹³ as long as they can demonstrate that WHR represent adequate security, which is under their control and easily enforceable. Such lending will, in turn, be harsher on banks that do not qualify for the IRB Advanced approach (Standard and IRB Foundation). This should not have a major impact on reducing competition between banks as the penalised institutions would not typically be very active in specialised lending markets.

On the other hand, the handling of heavy documentation will increase operational risks, which is a new feature in the BIS II capital adequacy rules. Properly implemented WHR legislation, therefore, has the potential to make lending against agricultural commodities more attractive to specialised banks and more competitive, thereby increasing available funds at improved pricing conditions. This is qualified by the longer term implications of the impact of WHR in the context of revised BIS rules, which are to take effect no earlier than the end of 2006, although they will be anticipated by the better prepared banks. The earlier mentioned move of the Central Bank of Ukraine to reduce reserve requirements applicable to WHR backed financing is, however, a good illustration of the credibility attached by banking regulatory authorities to such a mechanism. The combination of political risk mitigation through insurance or B loan structures and of the lower regulatory capital required when lending against WHR should, therefore, attract significant interest from the largest commercial banks in financing agricultural commodities in countries where such

¹³ Since the qualifying banks have typically developed a satisfactory track record on risk rating management, the concept of regulatory capital becomes essentially identical to that of economic capital.

investments are presently yielding too low a return on their capital.

IV. LEGAL ASPECTS OF SECURED LENDING

The Bank's ACFP relies heavily on the credit strength of straight forward access to security through out of court enforceability of WHR or actual repossession of commodities financed in repo transactions. Wherever such features are not available and sometimes as an additional security the team relies on third party guarantees through off take arrangements. This section examines the comfort levels that can be expected from WHR or repo based transactions.

A. WAREHOUSE RECEIPTS

As of today, the Bank has engaged in only one transaction where it was clearly exposed to the operating risk of agricultural commodity financing, which was mitigated by an acceptable WHR structure. It is expected that similar transactions will take place in the future, including in other countries which have enacted appropriate legislation. Where licensed and/or properly monitored warehouses can be relied upon, lenders can be satisfied that some specific risks are kept well under control, namely:

- (i) non delivery, as goods are stored in the warehouse as indicated on the receipt
- (ii) disputes over quantity or quality, which are also identified on the receipt
- (iii) ownership, unless the warehouse has knowingly issued a receipt for goods owned by a third party or failed to cancel existing receipts for goods which have been withdrawn (such gross negligence would be covered by an indemnity fund or other form of insurance), and
- (iv) all risks that can be covered by an insurance policy including theft, fire, flooding and other natural disasters, with the exception of force majeure, or risks that should be covered through an indemnity fund in particular fraud or gross negligence.

Receipts may be established either in the form of a single title document, in a bearer form or transferable via successive endorsements, or in two parts,¹⁴ one which is the title document, the other which is a pledge certificate which ought to be exempt from any other formal registration when issued by a licensed warehouse. In either case, the production of the original warehouse receipt, along with the pledge certificate in the second case, would allow the holder of such documents to obtain release of the goods stored, provided that they match the warehouse records, in particular that no prior cancellation had taken place. In case of default under financial obligations, creditors in possession of WHR should be able to easily claim their collateral and dispose of it, thereby bypassing lengthy and possibly unpredictable court enforcement proceedings. This apparent high level of comfort, which has not yet been tested by the Bank in its countries of operations, may, however, suffer weaknesses. Legal experts recommend exercising special care in the documentation of facilities collateralised by WHR.¹⁵ The following points should be given particular attention:

- While a loan agreement may be governed by non-domestic law, the perfection of security and the rights attached to the holding of WHR will most likely be governed or enforced under local laws.
- When the borrower is a domestic company and has other secured or non-secured

¹⁴ Generally in countries with a legal system inspired by the Napoleonic code.

¹⁵ The recommendations below are taken from presentations made by Michael Kenny, Partner, Watson, Farley & Williams and Nicholas Budd, retired Partner, Denton, Wilde & Sapte at the Warehouse Receipt Financing Conference, (29th 30th June 2004), Rotterdam.

creditors, in case of a bankruptcy, such creditors may seek to challenge the title claim under a WHR, on grounds that it could be construed as secured lending. Without prior registration of the security, a local court might therefore invalidate the lenders right to take possession of the collateral and to liquidate it for the settlement of their single claim. Consequently, it may be advisable to register the pledge of a WHR under local legislation even though this could be seen as defeating its very purpose that of being an out of court enforceable security.

- Lenders would typically seek over collateralisation to cover price volatility or market risk. In case of repossession and liquidation of the commodities substantiated by a WHR, it is important that the financing documents clearly describe the remedies available to the lenders, including the procedures to be followed in case of liquidation, and specify that the borrower will be entitled to any excess sales proceeds over full repayment of financial obligations including costs.¹⁶ It would, however, be dangerous to include in the loan documentation provisions to the effect that the Bank could sell or release the goods without accounting to the debtors as such provisions could be regarded by some courts as abusive lending.

B. REPO TRANSACTIONS

In repo transactions the Bank, through its agent, has actual title, though usually not possession, of the commodities financed. The operating risks described above would normally be mitigated through a highly selective choice of warehouses and close monitoring by specialist collateral managers. Transactions that circumvent the absence of proper licensing legislation are, however, difficult to implement and costly to operate. The Bank, nevertheless, enjoys at least the same level of protection as it would under a government regulated and monitored system.¹⁷ The ownership by the lenders of the commodities stored in approved warehouses eliminates any requirement to justify their right to repossession should the beneficiaries - the ultimate buyers, for trading or processing purposes - fail to meet their financial obligations at maturity.

There is a risk of recharacterisation in a repo transaction which, again, could be construed as secured lending.¹⁸ The counterparty would need to be a large corporate entity involved in a bankruptcy procedure with a number of unsecured creditors who were challenging the structure, under fairly sophisticated bankruptcy legislation. This is a rather unlikely scenario in the Bank's countries of operation. Such a risk could be mitigated through properly designed documentation.

V. RISK RETURN ANALYSIS

The Bank's commitments under the ACFP have been growing steadily over the last few years. In this respect, the Agribusiness sector policy has an excellent credit track record thus far. The programme has also had a highly successful transition impact as noted in section III above. PED's approach to analysing the return to the Bank of the programme is two pronged:

- (i) individual transactions will be looked at on a gross return basis, and
- (ii) a net return analysis (post cost allocation) will be used for the overall portfolio.

The Bank's mandate in the programme is to move transition forward in as many countries of

¹⁶ This has been introduced in every new piece of legislation dealing with WHR in all countries of operations where the Bank has actively promoted such institutional changes.

¹⁷ In all likelihood, until government regulated warehouses have established a proven track record, such private monitoring would in any case be an additional requirement of lenders.

¹⁸ Verbal opinion expressed by N. Budd who was interviewed by PED.

operations as can be targeted, based on the significance of their own agricultural sector. A net return analysis for individual transactions would penalise smaller transactions, which could possibly be used as tests for further commitments. A net return analysis would also penalise transactions in countries where large parallel investments in legal work and time spent through policy dialogue have not yet paid off in terms of actual business booked by the Bank. Conversely, where structures have been adequately tested, the Bank is usually in a position to justify an increase in its commitments at limited incremental costs, thereby obtaining compensation for its past and current investments.

The ensuing analysis is qualified by the somewhat approximate reliability of some of the data displayed. PED is very grateful for the Agribusiness Team's hard work and cooperation in researching and compiling profit and loss (P/L) and on and off balance sheet data to make possible a presentation which highlighted the programme's financial performance and which could, ultimately, lend itself to a sectoral comparative analysis. Since the portfolio under review is entirely made up of short term renewable facilities and is seasonal by its nature, loans or exposure under guarantees are neither outstanding throughout a whole year nor of a constant value throughout their short life. A financial return analysis requires comparing gross or net income to the average amount outstanding under a loan or guarantee. Unfortunately the latter is not readily available to banking staff and appears to be difficult to extract from the systems which are currently in place. These assumptions and adjustments must be considered along with the following information.

- The accounting period matches the seasonality of the programme and refers to all facilities which have been signed from mid year of the previous period to the first quarter of the current period. Revenues and expenses during the period include all such data relevant to a facility which was outstanding or in place during the period. The last period (2004) does not reflect revenues and expenses post mid year. The impact is, presumably, an understatement of net contributions as some revenues from the largest operating assets, with marginal matching expenses, have not been recorded.
- Average amounts outstanding under loan facilities were calculated backward based on the net interest income produced and the stated margin over the London Interbank Offered Rate (Libor). Average exposures under guarantees were estimated by the Agribusiness Team.
- Expense allocation per project is questionable and distorted by the incentive to allocate more time to projects where an appraisal fee may be agreed with the borrower and less time where it would be a sunk cost for the team. Furthermore, bankers may on a given mission be working on different transactions which are not all related to the ACFP. The expense allocation based on time sheets may, therefore, not accurately reflect the actual costs incurred in connection with the programme.
- In calculating the weighted average risk of the portfolio, 6W was entered as 6.5 and the weighting factor was the amount of the Bank's commitment,¹⁹ not the average outstanding.²⁰ (Please provide a simple explanation of the above sentence, either in the text or in the corresponding footnote.)

¹⁹ This terminology refers to the amount of the facility for which the Bank has signed a loan agreement even though it would typically be for a maximum of one year, renewable.

²⁰ The only exception is the EPH facility in Romania which, according to the Agribusiness Team, will never be drawn down. Although the related expenses are included in the total amount for the period, the commitment is assumed to be nil for the purpose of this calculation.

- All amounts are in US dollars which is, by far, the currency most used under the ACFP. Thus distortions due to foreign exchange variations over time are minimal.
- All figures provided have been compiled by the Agribusiness Team in consultation with PED. Adjustments, where deemed necessary, have been performed under the sole responsibility of the team. PED had extensive discussions on the reliability of the data and improvements to be made to its presentation but bears no responsibility as to its correctness. Net project cost is exclusive of risk adjustment. The latter, which will be discussed below, was estimated by PED.

A. GROWTH OF THE ACFP PORTFOLIO

To illustrate the growing significance of the ACFP, the following table shows the evolution of the Bank's commitments and average operating assets under the programme in 2002, 2003 and 2004. Since the bank was very active in attracting co-financing, the table also shows the increase in total financing, inclusive of co-financing.

US\$ millions	2002	2003	%	2004	%
Total commitments	145.9	265.6	82	359.4	35.3
Average operating assets	29.8	167.3	461	223.2	33.4
Total financing (including co-financing)	247.4	632.0	155	896.8	41.9

The average annual growth of the Bank's commitments over the last two years was an impressive 73 per cent while average operating assets climbed even more spectacularly due to the low starting point and have now levelled off, at a growth level of 33.4 per cent over the last season. It must be pointed out that, based on deals which have been recently approved but not yet recorded for the purpose of this analysis, the Bank's total commitments under the programme are projected by the team to be in excess of US\$ 500 million at year end 2004. This would translate to a growth rate in excess of 30 per cent in 2005.

Co-financing has caught up with a relatively stronger progression compared with the Bank's own portfolio in 2004 compared to 2003. This outlines the demonstration effect of the programme which is attracting an increasing number of commercial banks. It can be attributed to progress in the implementation of proper WHR legislation and, looking forward, to the incentives of booking such assets from a Basel II capital adequacy standpoint.

B. RISK ANALYSIS

The Bank's portfolio can be broken down into three categories of exposure, reflecting the degree of reliance on WHR as opposed to other securities to mitigate the Bank's credit risk:

1. **No WHR risk.** Unsecured loans to banks and primary corporate risks.
2. **Some element of WHR risk.** Loans and guarantees with primary recourse to financial institutions but collateralised by the commodity financed.
3. **Significant element of WHR risk.** The Bank accepts the operating risk associated with WHR although other risk factors are appropriately mitigated.

The Bank's strategy is to promote greater reliability on WHR in order to optimise the transition impact benefits discussed in section III above. This needs to be balanced with the requirements

of sound banking and can only be achieved as and when the necessary legislative and regulatory frameworks are in place and operating reliably. The following chart provides an indication of the evolution of each category of average operating assets, as a percentage of each year's total.

WHR risk element	2002		2003		2004	
	Average op. assets*	%	Average op. assets*	%	Average op. assets*	%
None	89.50	58	73	27	82.75	23
Some	65	42	192.60	73	243.80	68
Significant	0	0	0	0	32.80	9
Total	154.50	100	265.60	100	359.35	100

* in US\$ million

The Bank's ACFP portfolio is clearly following a trend of greater reliance on WHR or commodity collateral in order to support its credit risk. This can be illustrated by the fact that the *Some* and *Significant* categories in the chart above, which aggregated 42 per cent of total average operating assets in 2002 represented 77 per cent of the same total in 2004 with first transactions that included a significant degree of operating risk on WHR appearing in 2004. Incidentally, the improved credit rating of some banks has resulted in a shift of the Bank's exposure from *Some* to *None*, for the sake of simplification. This artificial distortion marginally softens the above trend.

While the portfolio can be segmented, for risk purposes, according to the nature and degree of the security, the Bank does not keep track of its exposure to specific commodities. Transactions are structured to pass market risk on to third parties via off take contracts or as straight corporate risks. The exposure to a single commodity is not, therefore, of great concern which may justify the absence of exposure analysis by commodity. It must be pointed out however that it would be very difficult for the team to determine its exposure at a given point in time since a large portion of the portfolio is made up of guarantees to institutions that report on the Bank's actual exposure retroactively, for example at the end of each month. This is the case in particular for the programme's largest single exposure to a client,²¹ which represents approximately 60 per cent of the 2004 average operating assets. Absent an analysis of risk diversification by commodity, it would be desirable to aggregate the Bank's exposure to its major counterparties, whether as straight corporates, off takers or conditional off takers.

Most importantly, the programme's credit quality is very high with no credit incident recorded as of year end 2004. The conservative structure of the transactions booked by the Bank and the selective choice of its counterparties either as straight corporate risks or off takers are the main reasons for this outstanding performance. The absence of equity risk and the short term nature of the portfolio make it easier to monitor the programme's overall risk quality and to react to possible market or institutional developments which could have an adverse impact.

C. RETURN ANALYSIS

Individual transactions are typically priced at a reasonably high level as gross returns on average operating assets indicate in the following chart. As is the case with the net return analysis below,

²¹ As long as the client concerned complies with a list of approved off takers and the exposure of the Bank agrees with predetermined percentages, the team is made aware of its exposure under repo transactions after the fact and possibly after the underlying transactions have been unwound. Only an audit of the client's books would allow the team to know at a given time the level of its exposure and the commodities concerned. Such an audit is unlikely to take place for relationship reasons, unless the Bank's guarantee is called.

gross return figures do not include the banking department allocated funding margin on disbursed loans, which would marginally improve the profitability of such transactions.²²

Gross Return	2002		2003		2004	
	Av. Operating Assets*	%	Av. Operating Assets*	%	Av. Operating Assets*	%
0-1%	354	1.2	9 899	5.9	7 051	3.2
1-2%	2 951	9.9	15 040	9	17 262	7.8
>2%	26 524	88.9	142 385	85.1	197 985	89
Total	29 829	100	167 324	100	222 298	100

* in US\$ 000

The above table shows that the pricing of individual transactions has been reasonably steady over time. Close to 90 per cent of the portfolio is made up of transactions whose combination of front end fees, commitment fees and margin or guarantee fee yield on a gross basis is in excess of 2 per cent. Given the short term nature of the portfolio, guarantee fee or margin over Libor are by far the largest components of the Bank's remuneration.

In order to evaluate the programme's financial performance, net returns were also calculated. This was done using the currently available cost allocation method. As was mentioned above, it may result in significant distortions at the level of individual transactions. Looking at the ACFP portfolio as a whole, these distortions become far less relevant if it is assumed that, within the portfolio, a degree of cross subsidising is acceptable, if not desirable. Indeed, in the process of building up the portfolio, it should be anticipated that existing mature transactions which only require renewals help absorb the cost of new developments including marketing, legal, policy dialogue and innovative structuring. Furthermore, within the context of increased reliance on collateralised transactions versus corporate or corporate guaranteed risks, it is critical to watch the evolution of the risk quality of the portfolio. The key indicator for the programme's performance in terms of the Bank's resource optimisation is, therefore, the risk adjusted return on operating assets.

The risk adjustment factor was obtained by calculating for each reference period the weighted average risk rating of the portfolio and using the general provisions matrix in the Bank's Provisioning Policy, further adjusted in accordance with the provisions of the Project Profitability Model with respect to non-sovereign loans of maturity under three years. The determination of the provisioning percentage and of the short term adjustment factor was in each case done by linear interpolation,²³ for the risk rating ranges [4-5] and [5-6]. The average country risk rating was assumed to be five throughout the period. The sector vulnerability is medium as per the Bank's Provisioning Policy. Unlike the Project Profitability Model which is based on discounting future cash flows over a period of several years, the risk adjusted return on operating assets is obtained by subtracting the risk adjustment ratio from the net return ratio, both being calculated for operations which are unwound within a year and, therefore, do not require an IRR type approach.²⁴

Year	Total commitments (US\$ million)	Total average operating assets	Net return on assets before risk adjustment %	Weighted average risk rating	Risk adjusted return on assets

²² The funded portion of the portfolio has been increasing over time, from 16 per cent in 2002, to 24 per cent in 2003 and 34 per cent in 2004.

²³ The spread with an exponential interpolation, which would better reflect the default probability progression, is not deemed to be significant in relation to other approximations in the model.

²⁴ This also circumvents the unorthodox methodology of discounting non-cash charges as pointed out in the Information Note Update of the Project Profitability Model.

		(US\$ million)		%	
2002	154.5	29.8	1.27	4.88	0.44%
2003	265.6	167.3	2.79	5.10	1.73%
2004	352.5*	223.2	2.45	5.21	1.21%

*Excluding EPH (US\$ 6.9 million)

In addition to being a clearly profitable activity, with a net contribution of US\$ 4.6 million in 2003 and most likely close to US\$ 6 million in 2004, the ACFP appears to yield a very satisfactory risk adjusted return on assets. This should be compared with other sector activities of the Bank which would require performing similar calculations, on a portfolio basis, but it must also be reconciled with the transition impact and risk to transition ratings of the respective activities. Presently, the ratios displayed in the above table can only be compared with similar indicators, which are only available to assess the financial performance of projects at the time of approval. Informally, it indicates that the combination of the portfolio profitability, risk quality and transition impact has scored *Very High* indeed. A number of issues could be raised regarding the correctness of cost allocations. For instance, larger costs were incurred in 2003 than in 2004, with a concentration of costs in Kazakhstan, where profits from new transactions will, for the most part, accrue in the future. On the other hand, more expenses than revenues have so far been accounted for in 2004, which significantly distorts the interpretation of the 2004 portfolio performance. As an indication, should net return be similar for both years, the risk adjusted rate on assets (ROA) in 2004 would be in excess of 1.5 per cent. Based on the above table, we can conclude that the Agribusiness Team appears to keep the risk/return balance of its portfolio well under control while maintaining a strong growth rate and excellent transition impact.

VI. THE BANK'S ADDITIONALITY

The financing of agricultural commodities was carried out in the Bank's countries of operations by international commercial banks before the Bank's involvement and it will carry on irrespective of the Bank's programmes. Some specialist banks established very close ties with international and local commodity traders long ago and are extending credit on the basis of their rewarding experiences and excellent credit track records on a less secured basis than under EBRD standards. Facilities are typically export oriented, in the form of pre-export financing, partly secured through letters of credit or other forms of transport documents and less concerned with integrity checks than the EBRD would require.²⁵ The Bank, in this context, demonstrates its additionality through a number of criteria which commercial banks would not promote but from which they will eventually benefit.

A. CRITERIA OF THE BANK'S ADDITIONALITY

1. **Design and functioning:** The Bank is promoting a reliable structure on which to base trade financing. In countries of operations that are moving along the path to legal transition the Bank is, thereby, creating momentum toward structured lending and away from relationship lending. Design and functioning in the Bank's facilities is more demanding in terms of transparency and integrity than would otherwise be the case. Where WHR legislation is not yet properly implemented and the Bank provides its guarantee or channels financing through local banks it would, in general, insist on the additional comfort of an assignment of the security in the financed commodity, thereby, paving the way for a more elaborate form of

²⁵ It is not unusual for such banks to book facilities in centres where commercial and private banking is protected under banking secrecy legislation. Undisclosed extra collateral may thus be available and enhance the credit structure of trade financing.

lending when the legal environment allows for it. In other situations, where WHR financing is a more remote proposition, the Bank's involvement would be justified by an opportunity to progress policy dialogue and set precedents such as quality monitoring of warehouses.

2. **Political risk:** In a number of situations, the Bank's additionality is demonstrated through its willingness to carve political risk out of a foreign sponsor's guarantee and to pass on to syndicated lenders the benefits of its preferred creditor status. The revolving credit facility to a client in Ukraine,²⁶ the contemplated transaction with a company in Moldova,²⁷ and past transactions in Kazakhstan,²⁸ are good examples of the importance of the Bank's political umbrella in inducing foreign sponsors to increase their volume of business in such countries and to involve commercial banks in transactions that would otherwise be too taxing on their regulatory capital.
3. **Technical cooperation funding:** The Bank successfully appealed to donors in order to support its efforts in promoting WHR in countries such as the Slovak Republic, Lithuania, Bulgaria, Ukraine, Moldova, Croatia, Kazakhstan and Russia. A detailed statement of technical cooperation (TC) funds made available over the years is shown in Appendix 7. The main donors have been the the United States, in particular through USAID, and Taiwan. Total TC commitments to the WHRP have amounted to US\$ 1.7 million since 1997.²⁹ Most of these commitments were secured during the 2002-04 period, which explains why only a fraction is shown as having been disbursed to date. By far the largest beneficiary is Ukraine with total commitments in excess of US\$ 1 million, including a USAID programme of US\$ 900,000. Funds are used primarily to provide consulting services to governments for the drafting of appropriate legislation and the setting up of warehouse regulatory agencies. In addition, USAID, at the EBRD's request but at its own discretion, directly funded projects in Poland, Bulgaria, Kazakhstan, Croatia and Romania.
4. **Maturity:** A number of transactions are presented by the Agribusiness Team as multi-year Revolving Credit (R/C) facilities. The ACFP, however, is a seasonal trade financing programme under which individual transactions are reviewed annually and require no financial commitment beyond the terms of the trade which are typically for less than a year. Annual renewals are processed either on a no objection basis, for larger transactions which are not part of the Framework for approval purposes, or via delegation to OpsCom for those which are under the Framework. The window dressing of such facilities as term commitments is somewhat artificial and the Agribusiness Team should not feel compelled to justify the Bank's additionality in this programme through its ability to extend credit beyond

²⁶ This transaction is only remotely related to WHR but could be said to have contributed to the Bank's efforts to introduce new legislation in the country. It should be expected that, as and when WHR financing becomes a reality in Ukraine, the structure of the revolving credit will be amended to reflect a greater share of local risk taking by banks. It remains to be seen, however, whether pricing truly reflects the Bank's additionality through its preferred creditor status.

²⁷ This proposed investment has been under scrutiny due to the borrower's dominant market situation in the country. The size of the contemplated financing in Moldova is USD 40 million, up from an existing commitment of USD 6.1 million. This coupled with the interest shown by several potential B lenders to take up to 50 per cent of EBRD's commitment, are clear indications that such transactions are well suited to some early transition countries and of the Bank's additionality in channelling funds from the commercial banking sector to places where it would otherwise not have been available.

²⁸ Since rating agencies have promoted Kazakhstan to investment grade, financial institutions have been encouraged to accept direct Kazakh risk which puts pressure on the pricing premium that the Bank could expect for being a lender of record. The Bank's presence in syndicated transactions is, nevertheless, still regarded as a positive feature in the face of sometimes unpredictable political events.

²⁹ This includes a proposed US\$ 450,000 grant which USAID is contemplating allocating to the Moldovan project but is not yet stated in the appended table.

maturities commonly seen in the market. Indeed, additionality ought to be sufficiently verified through design and functioning as well as the use of the Bank's attributes, including the mobilisation of donor's funds to progress legal transition, as was seen above.

B. IMPACT OF THE PROGRAMME'S SUCCESS

As the Bank records successes in its efforts to promote WHR financing, its additionality is increasingly harder to demonstrate. This should be regarded as a tribute to its achievements and an encouragement to pursue its mission.

In the most advanced countries where political risk is not a major concern of the commercial banking sector, the Bank's successful promotion of WHR legislation has resulted in the private banking sector taking over from the EBRD altogether. This was the case for instance in Bulgaria, Lithuania and the Slovak Republic. It may well become the case in other countries as shown by a recent transaction.³⁰ Competition from the private sector in these countries confirms that the implementation of appropriate WHR regulations and legislation had the expected outcome of attracting private funding, thereby pushing the Bank to look for new frontiers to develop its ACFP. A proposed transaction in Ukraine shows how the Bank may be in a position to pioneer WHR based financing in countries where it has been instrumental in its development. In this case, the new frontier concept applies not only to the untested regulatory aspects of WHR but also to the structure of the facility which finances upstream domestic activities of the borrower without the backing of export contracts.

VII. OVERALL ASSESSMENT

PED's rating of the programme's overall performance was *Highly Successful*. This is based on the achievements summarised below with respect to the transition impact, the Bank's additionality and the performance of the Banking Department.

Transition impact has achieved very high scores in the short term with respect to transparency, increased competitiveness and the provision of liquidity to the sector. A strong longer term potential is anticipated for transition impact, with WHR policy implementation being a stepping stone to the development of a commodity futures market in the region and providing strong incentives for commercial banks to invest in the sector in order to optimise their return on regulatory capital when new Basel II rules are implemented. PED's rating of the programme's transition impact was, therefore, *Excellent*.

The Bank's additionality, on a deal by deal basis, is unevenly verified. Some transactions have been booked for relationship reasons, with a view to maximising earnings or to capitalising on

³⁰ In December 2003, the bank agreed to take a US\$ 7.5 million participation in a US\$ 85 million international syndication. This was a similar structure to a proposal made earlier by the Bank to channel funds to finance multiple borrowers, using the same WHR collateralised structure and the backing up of export contracts. The Board had approved the principles of this transaction, leaving it to OpsCom to agree on the final deal. The improved risk rating of the host country and the successful implementation of WHR legislation made it attractive to the private sector to underbid the EBRD and win a co-arranger mandate. The new borrower is a government owned entity, pricing is less than originally anticipated by the Bank, credit terms are at least as stringent as under the EBRD's offer, no conditionality specific to the Bank's mandate is incorporated in the documentation and, as a mere participant, the Bank's preferred creditor status has no bearing on the syndicate's exposure. Under such circumstances, additionality is hardly or not verified. The Bank had strategic reasons to take a back seat in this transaction and went ahead. The Board was notified through the monthly information report.

past development efforts under unmitigated competitive conditions with the private sector.³¹ PED rates the Bank's additionality through the ACFP as *Verified at Large*. This is, primarily, because of the Bank's achievements in introducing internationally acceptable design and functioning, which is based on effective collateralisation or WHR for the financing of trade in the agricultural sector in several countries of operations, and also because of its demonstration effect in pioneering such financing and, thereby, encouraging an increasing flow of private sector bank investments as syndicated lenders through political risk mitigation. In this respect, the Bank's additionality is verified through its unique contribution to moving legal transition forward. This has been achieved through policy dialogue, the determination and expertise of a dedicated team as well as the channelling of substantial TC funds to further this purpose. Such critical actions could not have been expected from the commercial banking sector. Success, however, breeds fewer opportunities as the Bank gets displaced from areas where it has best achieved its objectives. There are, however, still new frontiers and this could not be more in line with the Bank's mandate.

The banking team responsible for the ACFP must be commended for its outstanding achievements. In line with the programme's stated objectives, fulfilled through transition impact achievements, a portfolio which includes commitments in excess of US\$ 500 million will be on the Bank's books by year end 2004. Its profitability is significant, it scores very high on a risk adjusted return on assets and it has an immaculate credit record so far. Most importantly, the Bank's reputation has been enhanced by the quality of its coverage of the industry, government and regulatory bodies involved in the programme. The EBRD and its staff have been repeatedly praised by industry specialists in the region for its pioneering and effective commitment to developing WHRPs and facilitating investments in agricultural commodity financing. The Bank's performance was, therefore, assigned an *Excellent* rating by PED.

VIII. LESSONS LEARNED AND RECOMMENDATIONS

A. INDUSTRY SPECIALISATION

Consistency and determination in promoting the ACFP and expanding its geographical implementation have been critical aspects of its success. The EBRD's name is regularly quoted as one of the most active institutions in the development of the WHRP in the Bank's countries of operations. The EBRD is also recognised for its expertise in dealing with the implications of WHR, including financial, economic, political, legal and credit implications.

LESSON:

Industry specialisation can enhance the Bank's image. Industry specialisation is key to the promotion of complex programmes as it provides a wealth of expertise from a technical and credit perspective while enhancing the Bank's image through the consistency of its marketing activity and the visibility of its own specialists.

B. SUCCESS BREEDS DIMINISHING ADDITIONALITY

In a number of countries of operations, the Bank found that as its efforts to promote the WHRP were rewarded, commercial banks aggressively entered this market and the Bank's yield criteria could no longer be met while its additionality could only be verified on grounds of country risk.

³¹ Reference is made to working capital facilities to international traders, unconditionally guaranteed by their parent, or to participation in syndicated loans arranged by commercial banks with no conditionality specific to the EBRD.

This creates uncertainty as to the ongoing profitability of the programme, which has a constant need to expand to uncharted territories. Furthermore, with a significant proportion of the programme's assets and net revenues coming from a single set of transactions, the Bank is particularly vulnerable to a successful outcome of its legal transition efforts affecting this specific investment.

LESSON:

Fulfilling the Bank's mandate may result in reduced additionality. Where the Bank's transition impact achievements are substantiated by competitive pressure from the commercial banking sector, the profitability of the Bank's portfolio is bound to be adversely affected. It will need to look for alternative investments where additionality can be verified and transition impact remains to be delivered. It is also important for the Bank to monitor its portfolio concentration and mitigate its vulnerability to large single sets of transactions.

C. TRACKING THE PROFITABILITY OF TRANSACTIONS OR A PORTFOLIO

Collecting all the financial data necessary to allow for a profitability analysis of the portfolio was very time consuming. Yet the quality of this information was not satisfactory. It is disconcerting that information such as the average amount or exposure outstanding under loans or guarantees over a set period of time is not easily available to bankers. As was noted above, the implementation of the allocation system results in significant distortions from transaction to transaction. Bankers should be in a position to evaluate the profitability of their transactions and of their relationships with clients. This requires not only knowledge of revenues and expenses but also the ability to match net profit with operating assets representing the utilisation of the Bank's capital.

RECOMMENDATION:

User friendly methods of comparative performance analysis at project, client and portfolio levels must be further developed. Since the Bank's Risk Capital Model cannot be used for the purpose of comparing the financial performance of projects, other methods can be developed. For the purpose of this study, an evaluation of the risk adjusted return on assets was attempted. The Bank's Project Profitability Model is conceptually similar to this approach. It should not be restricted to ex-ante analysis, namely prior analysis which is based on predicted results, and it should be made more user friendly for bankers and/or other users of comparative performance analysis at project, client and portfolio levels.

D. TRANSFER PRICING

When dealing with international trading companies on the basis of working capital facilities or financing domestic transactions with conditional off takes from strong third parties, the Bank does not focus on the terms of the trade but rather on the financial strength of its corporate counterparty and the value of the financed commodity, which is generally over collateralised. Transfer pricing may, therefore, take place unbeknownst to the Bank which could be seen as turning a blind eye to such practices.

RECOMMENDATION:

The risks of transfer pricing need to be minimised. It is important for the team to clearly specify to its clients that the Bank does not condone abusive trade practices and may, occasionally, require justification that trading is carried out on an arms length basis as a condition to extending credit or renewing an existing facility. While this may not prevent all forms of transfer pricing, it would reduce the Bank's resulting reputation risk.

E. RELIANCE ON THIRD PARTIES FOR EXPOSURE REPORTING

When the Bank has negotiated a blanket guarantee to a financial institution under trade financing facilities which meet specific conditions, the maximum exposure is set as well as the nature of the ultimate credit risk such as corporate guarantees or specific securities. The Bank is only retroactively notified about its actual exposure, however, based on pre-agreed reporting procedures. As a result, the Bank cannot monitor its actual exposure to specific counterparties or to the underlying commodities financed on a day to day basis.

RECOMMENDATIONS:

There must be adequate exposure reporting. From a credit control point of view, while maximum exposure under a facility is known at all times, it may not be the same for aggregate exposure to counterparties. It is important to ensure that the Bank's maximum credit limit to international traders or other counterparties with whom it conducts direct business includes the maximum amount of guarantee that was approved for conditional off takes or pursuant to other forms of credit comfort under programmes managed by third parties.

Systemic risks which may have an impact on particular traders should be monitored. It would be desirable to monitor the Bank's indirect exposure to financed commodities. While transactions are always structured so as to eliminate market risks, systemic risks affecting specific commodities may have an impact on particular traders who are over exposed to such commodities and, therefore, may also have an indirect impact on the Bank's counterparties.

F. DELEGATIONS OF APPROVAL

The Regional ACFP benefits from a specific delegation of approval from the Board up to a maximum amount of US\$ 200 million, for existing transactions that do not individually exceed €25 million. Proposed recent changes would introduce some strengthening of this delegation by means of a reduction to €10 million of the cap on new transaction not requiring formal presentation to the Board and a monthly reporting of sub-projects under the Framework within 30 days of signing. There is strong justification for a generous delegation. All transactions are short term and a large number of those included under the Framework are annual renewals. This is a substantial departure from the approval process which applies to term loans or project finance facilities. The Board is also updated regularly on the ACFP, which provides it with an opportunity to control the Bank's sector strategy and credit track record. The delegation, nevertheless, gives a large degree of discretion to the team with respect to transactions that would qualify for OpsCom approval only as opposed to those which will be submitted to the Board.

RECOMMENDATIONS:

The Bank's aggregate exposure limits to single counterparties and groups should be applied. It would be advisable to take a conservative interpretation of the €10 million or €25 million limit and consider that it applies to the Bank's aggregate exposure to a single counterparty or group, as opposed to individual transactions.

The Board should be informed on a no-objection procedure basis about project variances.

Irrespective of the Framework boundaries, the Board should have an opportunity to comment on transactions which are distinctly different from the transactions which were originally approved through a no-objection procedure rather than the monthly information report. This could be the case when, for instance, in the final version of a negotiated facility the Bank's additionality is severely reduced even though sound banking principles and transition impact are preserved or possibly enhanced.

G. INDEMNITY FUNDS

The condition precedent of an indemnity fund covering risks not otherwise coverable in the insurance market is a requirement over which the Bank has been struggling. The primary reason is that initial funding could hardly be sourced from anywhere other than governmental contributions and this is typically met with extreme reluctance. The functioning of the fund and the build up of appropriate reserves, in the longer run, should eventually come from members' contributions through warehousing fees. Unless a solid track record of strict monitoring under high standards has been established, this means that good warehouses will be expected to subsidise bad warehouses. Unless such mutuality is made more selective, the better warehouses will be reluctant to join an indemnity fund open to any warehouse. Experience has shown that the indemnity fund requirement is often circumvented with limited prejudice to the development of WHR backed financing.

RECOMMENDATION:

A select group of warehouses could join forces and, thereby, enhance the ACFP. The example of Kazakhstan where an indemnity fund was successfully put in place in record time following the enactment of WHR legislation shows that it may be preferable to have a club approach whereby the better or financially stronger warehouses initially join forces. In countries where the implementation of an indemnity fund raises too many hurdles, it may be more practical and no more risky for the Bank to use collateral managers in the selection and monitoring of warehouses, irrespective of their certification by a government agency. If obtainable, insurance against fraud should also be obtained. There has not yet been any claim made against an indemnity fund. This means that the ability of an indemnity fund to cover risks such as fraud is so far untested. Due diligence about and a selective approach toward warehouses are likely to be at least as important as the comfort of an indemnity fund.

H. MULTI-YEAR FACILITIES

Trade financing of agricultural commodities is a short term credit extension. This is further enhanced by the objective of the Bank's programme which is to structure transactions on the basis of WHR which would typically indicate a storage period under a year, unless renewed. From a credit perspective, approval for renewal is sought annually. Yet a number of projects are presented to the Board as multi-year facilities, subject to annual review on a no-objection basis. Commitment fees are generally stipulated, however, they must often be either waived or not collected since they can hardly be calculated using the the portfolio profitability data submitted by the team. This highlights the short term legal issues which arise from such transactions.

RECOMMENDATION:

Short term facilities do not need to be presented as term facilities in order to secure approval. Multi-year presentations are unnecessary and misleading. The Bank's additionality can be sufficiently verified through other aspects of the ACFP and need not be artificially enhanced with the appearance of a longer term credit extension than would normally be available in the market. Furthermore, this could give the wrong impression, namely that the programme addresses long term financing requirements. Although such investments may be needed in the primary agricultural sector or downstream, for transportation and storage infrastructure, this is totally outside the scope of the ACFP. Short term working capital facilities should not need to be dressed up into term facilities in order to secure approval.

I. RECHARACTERISATION RISK:

Section IV above pointed out that the strong comfort provided by WHR legislation, which allows for out of court security enforcement, could potentially be weakened in the case of recharacterisation by a court in the context of the bankruptcy of the borrower. The Bank's due diligence undertaken for its first project involving direct WHR risk in Kazakhstan covered this issue.

RECOMMENDATION:

Use local legal counsel to identify direct WHR risks. It is very important that projects involving direct WHR risks are scrutinised by local legal counsel, with a view to determining the extent of the risk and whether mitigating measures such as the registration of security would be appropriate.

APPENDIX 1

A BRIEF DESCRIPTION OF THE FIELD WAREHOUSE PLEDGE AS AN APPROPRIATE SECURITY DEVICE FOR DEVELOPING COUNTRIES AND THE NEW MARKET ECONOMIES

by Nicholas Budd
Partner, White & Case
Paris

I. General Description and Background of Field Warehousing

Field Warehousing is a security device which enables the borrower to deliver to the lender legally valid documents of title and to grant a possessory pledge of goods stored in the borrower's own plant, mill, refinery or warehouse. The issuer of the field warehouse receipts creates a legally independent warehouse within the borrower's premises by leasing the storage area, controlling movements in and out, and posting prominent signs giving public notice that the controlled area is operated by the field warehousing company. Access to the warehouse is controlled either by members of the borrower's staff who are temporarily employed by the warehouse company for this purpose, or by members of the field warehouse company's staff. The warehouse records and inventory levels are periodically audited. The integrity of the staff (whether permanent or temporary) and contractual liability of the field warehouse company are insured under a fidelity and errors and omissions policy.

In a few words, the objective of field warehousing is to enable the lender and borrower to enjoy the benefits of warehouse receipt financing (*see II below*), but instead of moving the goods to the warehouse, the warehouse is moved to the goods. In doing so, the possessory pledge is converted to a relatively convenient and cost-effective form of security with a much higher degree of legal protection and practical control than is afforded by a registered charge or security interest. This technique addresses directly the most critical commercial finance issues in developing countries where perceived risk is high and both the legal structure and local bank sophistication in collateral management techniques are, for the time being, in need of substantial development. This development process may be inevitable, but will take time, and in the meanwhile field warehousing, where legally recognized, can provide a useful halfway house to enable lenders to lend safely and for borrowers to borrow efficiently.

For the same reasons that field warehousing is an appropriate financing tool today in developing countries and in Central and Eastern Europe and the CIS, field warehousing was instrumental in the financing of United States' agriculture, light industry and wholesale distribution during the fifty years preceding the adoption of the UCC. At one time there were over 200 field warehousing companies in the United States and Canada, most being owned by terminal warehouse companies. With the adoption of the UCC, and perhaps more importantly, the increased sophistication of local banks in collateral management and competitive pressures, field warehousing as a security device has all but disappeared except in large-scale banker's acceptance financing programmes described below. In France, Belgium, and many Latin American countries, field warehousing continues to be widely accepted as a practical and safe security device, and during my experience as a commercial finance lawyer we have seen the technique employed in 26 countries throughout the world.

APPENDIX 1

II. Advantages of Warehouse Financing Generally

The possessory pledge and financing of goods stored in independent warehouses has been a financing technique employed by lenders since at least the 5th Century B.C. Even today in countries such as the United States and England which have adopted registration by filing, creditors holding documents of title such as warehouse receipts enjoy a super-preferred status vis-à-vis other secured creditors and expedited treatment in insolvency proceedings.

The reasons for the preferred status of warehouse receipts as security are several:

- ✂ In many countries a document of title held by a good faith purchaser or lender cuts off claims of unpaid sellers and other encumbrancers, and need not be

registered. *This is an extremely important advantage in countries in Central and Eastern Europe and the CIS where the chain of title to goods and the existence of competing creditors and unpaid sellers are often difficult to verify with certainty.*

- ✂ A lender holding a warehouse receipt has a claim against the issuer as well as the borrower in the event of the non-existence or unauthorized release of the collateral. This is why banker's acceptances secured by warehouse receipts or bills of lading are sometimes referred to as “three party paper” (the borrower, the accepting bank and the custodian of the collateral).
- ✂ In the event of loan default collateral covered by documents of title can be auctioned or sold promptly and at minimal cost “as is where is” by the lender by negotiation of the document or written notification to the warehouse operator.
- ✂ Even in OECD countries, the bankruptcy laws and tribunals can deal far more easily with security given in the form of a possessory pledge, because the identity of the collateral is incontestable and the intent of the borrower to pledge the collateral is clear. When a pledge is coupled with delivery of a title document, disputes as to ownership and competing claims are also avoided. One reason for the slow processing of claims and pro-borrower and pro-unsecured creditor bias of courts in security registration jurisdictions is the potential for over-collateralisation and disputes over title and the formal aspects of perfection. These problems are substantially reduced in cases where the borrower has delivered possession of specific, identified collateral to a third party bailee expressly for the purpose of securing the loan and the bailee has issued a negotiable title document, and the courts and bankruptcy laws in a number of countries accept this important distinction.
- ✂ Certain types of highly efficient money market instruments, such as eligible banker's acceptances in the United States and England, require the lender to hold title documents as a condition to the use of central bank rediscount facilities, and in many OECD countries these facilities are not subject to mandatory reserve and provisioning requirements as are other loans of similar tenor and form where security is taken merely by registration. United States banks are expressly authorised under Federal Reserve regulations to create banker's acceptances against goods in foreign storage and to use field warehouse receipts as title documents.

APPENDIX 1

III. Legislative Implementation

The law or practice of most countries already recognizes the concept of the possessory pledge and the legal standing of independent warehouses to act as pledge holders. Field warehousing in those countries which practice it has developed largely as a matter of case law over the past hundred years, in which the courts have considered whether particular field warehouses are operated in a sufficiently independent, continuous and notorious manner so that possession can be said to have passed to the warehouse company and constructively to the lender. In developing countries and new market economies, these standards could be codified to speed up the process and remove any doubt.

The laws relating to documents of title to goods held by recognized bailees and the rights of good faith purchasers and encumbrancers holding such documents are not well developed in the

new market economies and in many developing countries, and this is an unnecessary and easily corrected impediment to both trade and commercial finance. Any number of North American, European and Latin American jurisdictions could provide workable models. The modernisation and harmonisation of laws dealing with title documents hopefully will be examined as part of the UNCTAD-sponsored LEGISPORT project involving over 50 countries.

As a related matter, the laws concerning the qualification, supervision, and insurance of independent warehouse companies, while probably not essential to accommodate field warehousing, should nevertheless be brought into line with international standards. Many Latin American countries have quite advanced laws relating to warehouse operator qualifications.

One issue which is key to the efficient and convenient operation of field warehouse finance is the clarification of the right to rotate and substitute collateral without affecting the validity of the pledge, in order to facilitate normal commercial operations. Another issue is the clarification of laws relating to the commingling of fungible goods which may be pledged to several lenders or which may constitute both pledged and unpledged goods. The law regarding title to bulk goods was resolved favourably in the United States under the Uniform Warehouse Receipts Act and latterly under Article 7 of the UCC, but until recently was a problem under English law. England has now adopted the US practice.

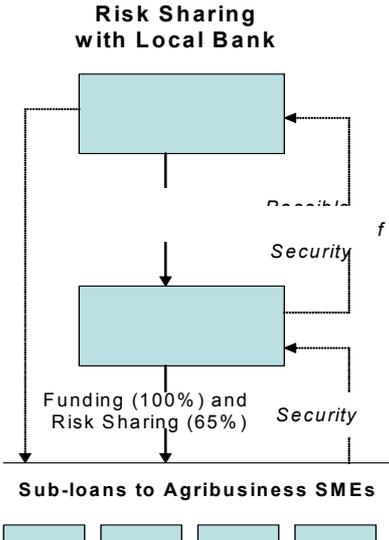
IV. The Relationship between Field Warehousing and Security by Registration

Field warehousing can and does exist side-by-side with security by registration, however apart from (and because of) its control features, holders of title documents and possessory pledges have procedural advantages and priorities. The control elements and procedural and priority advantages of field warehousing are precisely suited to the needs of commercial lenders, both local and international, operating in the new market economies and developing countries, and should be available as an alternative means of taking security in goods in these countries. With the passage of time, as local banks develop effective collateral management capabilities and the laws relating to registered security and insolvency develop, this technique will doubtless be used only in exceptional cases, as it is in the United States today. In the meantime, however, and probably for the next ten years at least, field warehousing where recognized will provide a powerful tool for lenders to lend and for borrowers to maximize the collateral value of their inventories.

APPENDIX 2

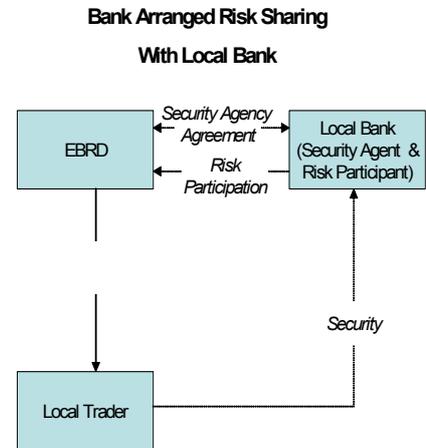
Other Financing structures

- 4) **Risk sharing (co-financing) with local banks as arranger** in loans to agribusiness companies secured by agricultural commodities. Under this structure, the Bank takes a portion of the risk (up to 50%) under the sub-loans provided by the local bank to local agribusiness companies. Although the Bank may also provide funding to the local banks for on-lending to end borrowers, usually such participation is unfunded, making the

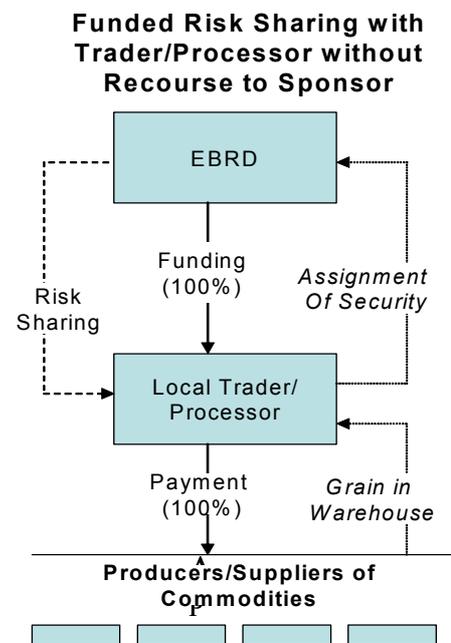


provision of local currency financing easier. This structure has mainly been utilised in countries with a more developed local financial institutions sector, such as Croatia, Romania and Moldova.

- 5) **Bank arranged risk sharing with local bank participation** in loans to agribusiness companies secured by agricultural commodities. Under this structure, the Bank lends directly to local traders with the participation (most likely unfunded) of a local bank, who also acts as a security agent on behalf of the Bank. This structure is currently under consideration by the Bank for the 2004 commodity financing program in Kazakhstan.



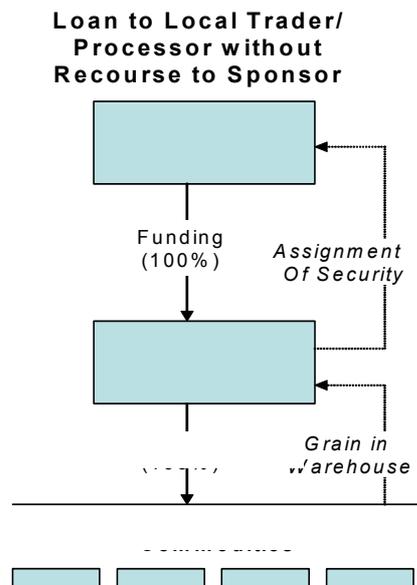
- 6) **Funded risk sharing with a trader/processor without recourse to a sponsor.** Under this structure the Bank provides short-term financing to agribusiness entities, traders or processors, normally subsidiaries of multinational groups, and shares some of the risks of the counterparts, such as the operating risk of warehouses. The Bank does not have recourse to the parent company, and, therefore, has to be satisfied with the performance risk of the borrower, who undertakes to ensure the integrity and market value of collateral. Normally, the Bank establishes a conservative advance ratio (i.e. the disbursed amount of the loan to the market value of



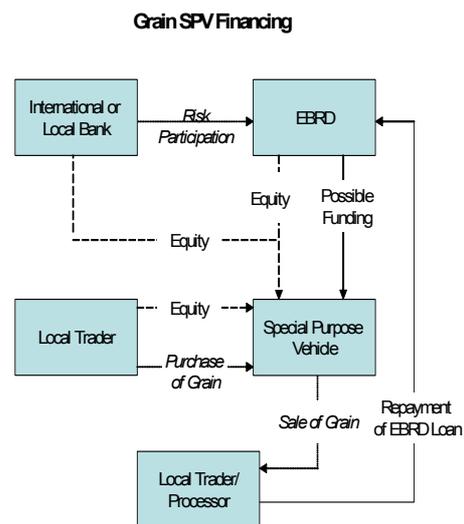
ENDIX 2

commodities). When the market value of commodities drops, the borrower has two options: either to repay partially the loan, or to put in additional collateral, so that the advance ratio is restored again. This requirement may be relaxed in transactions with recourse to a parent company. As a general rule, this structure is feasible only with very reliable counterparts and in the countries where WHR legislation and institutional mechanisms, such as licensing and inspection of warehouses, are in place and working. This structure has not yet been utilised, but it may be used by the Bank with clients and other reputable traders in selected countries (e.g., Kazakhstan) in the future.

7) **Loan to a local trader/processor without recourse to a sponsor.** In this structure, which has not been used to date, the Bank would take the full risk of the borrowers (local traders/processors) without recourse to a sponsor. The difference with the previous structure is that under this structure the Bank does not share the risks of the ‘borrowers’ counterparts (e.g., warehouses). Similar to the previous one, this structure can only be implemented on a very selective basis with reliable counterparts. An adequate WHR legislation and institutional set up would be beneficial when choosing this structure. Conservative advance ratio, market call mechanism, fixed price off-take contracts with reliable counterparts could all be used to help mitigate the market risk in this structure.



8) **Financing agricultural commodities via Special Purpose Vehicles (“SPV”).** In this structure the Bank, in close co-operation with a trader and most likely an international or local bank, will establish an SPV which could be owned by the trader and the financiers (as illustrated). The SPV would then purchase commodities from local trader(s) (with financing provided by the Bank) and sell these forward to traders/processors or for export (the buyer and seller of grain could be the same entity). This structure would enable the traders to receive off-balance sheet financing for commodity purchases and would enhance the credit risk for the Bank since the Borrower (i.e. the SPV) would be the owner of the commodities and would therefore not need to rely on the enforcement of the collateral, similar to the repo structure. The Bank is currently exploring the viability of this structure with an international trader/processor with a view to implement it for the 2004 harvest.



APPENDIX 3

Annex 1 to BDS00-133 (Addendum 4) 23 December 2003
Agricultural Commodity Financing Programme

**Update on the Status of Implementation of the WHR Law
and the Bank’s Involvement**

Below is a country by country update on the current status of the implementation of warehouse receipts in a number of the Bank’s countries of operations.

Hungary

Hungary was the first country in the region to pass and implement specific warehouse receipt legislation. The Bank has never participated actively in lending against warehouse receipts in Hungary (although a number of enquiries have been made for possible co-operation with local banks) and did not assist in the implementation of the warehouse receipt legislation. However, lending against the instrument is very active in Hungary and local and international banks are very appreciative of the instrument.

Slovakia

Slovakia was the first country, in which the Bank participated in lending against warehouse receipts. The Bank is no longer an active participant in lending against WHRs in Slovakia. However, following the successful implementation of warehouse receipts in 1998 the Bank participated actively for four seasons.

The first time the Bank got actively involved in the implementation of warehouse receipt legislation was in Slovakia, where the Bank was approached by the Slovak Ministry of Agriculture following the passing of the warehouse receipt law. The Bank provided technical assistance (which was funded by Taiwan) to assess if the licensing agency which the Ministry was intending to establish was adequately staffed and trained.

Bulgaria

When the Bank joined the Bulgarian Warehouse Receipt initiative in 1999, the warehouse receipt law had already been passed with the assistance of USAID and the World Bank. However, it was not implemented and the key element missing was an indemnity fund. In light of this the Bank signed a Memorandum of Understanding on the 26th of July 1999 which outlined the governments intention to fully implement the warehouse receipt law, including the establishment of an indemnity fund and the Bank's undertaking to provide financing against warehouse receipt (via local banks) once the legislation had been implemented.

Following the successful implementation, including the establishment of the first indemnity fund in the region, in 2000, the Bank actively participated in lending against warehouse receipts for 3 seasons.

Poland

In Poland, during the latter part of the nineties, USAID provided the Polish government with a sizeable technical assistance package to ensure the implementation of warehouse receipts. As a result all of the secondary legislation was drafted and warehouse owners and industry participants were trained in how to use the new legislation. Unfortunately, the legislation was not passed until 2000, when the USAID assignment had ended and as a result there were limited resources to actually implement the law and it is only this year that warehouse receipt are finally being issued in Poland.

The Bank contributed actively to the drafting of the warehouse receipt legislation during 1999, as a result of which the concept of an indemnity fund was introduced into the legislation. In addition the Bank signed a Memorandum of Understanding between the Bank, the Polish Ministry of Agriculture and the American Embassy, the intention of which was to ensure that the law was finally passed and the possibility of using American donor funds to establish an

indemnity fund. As a result the law was passed in 2000. However, the potential funding for the indemnity fund was never allocated because of disagreements with the Polish National Bank³². Following the passing of the Polish warehouse receipt law in late 2000 nothing happened in terms of its implementation, as a result the Bank provided the government with technical assistance (funded by the United Kingdom) to try and re-establish the momentum and get the warehouse receipt legislation fully implemented.

The 2003 harvest is expected to see the first issuance of warehouse receipts. A number of local banks are enthusiastically looking to provide lending against the new instrument, to date there has been no need for the Bank's involvement in the lending against warehouse receipts.

Lithuania, Latvia and Estonia

Following the Bank's successful experience with the introduction of warehouse receipts in a number of the Bank's countries of operations, Bank staff at the Vilnius Resident Office thought that warehouse receipts would be beneficial in Lithuania. As a result a meeting was arranged between the Bank, the Lithuanian Ministry of Agriculture and other industry participants in the fall of 2001. The Bank introduced the concept of warehouse receipts and as a result a discussion of the potential for warehouse receipts in Lithuania was initiated. Following the completion of the meeting, a working group was established (with the participation of the Bank) headed by the Lithuanian Ministry of Agriculture. The Bank provided the working group with the Slovak, Polish and Kazakh warehouse receipt laws as examples. During the winter of 2001 and 2002 the law was drafted and the Bank provided its comments via the working group on a number of the drafts. In addition, the Bank provided the Lithuania Government with technical assistance (funded by Taiwan) to pay for the hiring of a bus which drove a number of members of the working group to Hungary and Bulgaria for the participants to meet the people who had implemented and were using the warehouse receipts in these countries. As a result of the lessons learned from the trip, the warehouse receipt law was passed and implemented (including the funding and creation of an indemnity fund) for the 2002 harvest.

Following numerous discussions with local banks on the implications of the introduction of warehouse receipts, local banks were of the opinion that the legislation was an improvement to the current lending practices and decided to proceed with lending against the new instrument without the participation of the Bank. However, it should be noted that a number of international banks and one regional bank operating in the Baltic's have requested the Bank's assistance in implementing similar legislation in Estonia and Latvia to assist with the increasing commodity export flows, which are passing through the region.

Kazakhstan

During autumn 2000, Bank staff visited Kazakhstan to explore the potential for warehouse receipts. The Kazakh Ministry of Agriculture, in co-operation with the Kazakh Grain Union were already working on drafting the legislation and the Bank assisted by providing examples from Slovakia, Bulgaria and Poland. Following the passing of the law in early 2001, the Kazakh Ministry of Agriculture requested technical assistance from the Bank to ensure that the law

³² In the mid nineties the Americans had provided Poland with US\$ 5 million, to be used for Polish Co-operative banks. However, because of deviating political agendas between the Americans and the Polish Government these funds were never actually utilised and the idea was to unblock these funds and reallocate them for the creation of an indemnity fund. Since the money was sitting in a fund which was controlled by the American Embassy, the Polish Ministry of Agriculture and the Polish National Bank all participants needed to vote in favour of this new intended utilisation and unfortunately the Polish National Bank would not agree to this. As it happens today the Polish Government and the Americans have sorted out their differences and the money is being used for their originally intended purpose.

would be implemented. Because of time pressure, Bank staff met with USAID and found that they would be willing to provide the necessary assistance without the direct involvement of the Bank. Because of language barriers it was decided that the best consultants for the assignment would be the Bulgarian experts who had implemented the legislation there and as a result the Bank assisted in locating the necessary people and within a couple of months of the initial request by the Ministry consultants were on the ground in Kazakhstan.

Today the form 13 has been successfully replaced with the warehouse receipt in Kazakhstan and more recently the government have initiated the establishment of an indemnity fund, the Bank feels confident that warehouse receipts will play a very important role when lending against agricultural commodities in the future. Because of the size of Kazakhstan and the potential for exports, the Bank consciously decided to involve western commercial banks as early as possible. As a result of these efforts, a number of banks have participated in the Bank's due diligence visits to Kazakhstan and in the Bank's financing to date. The Bank is now witnessing an increased interest from western banks in the financing against Kazakh warehouse receipts. This season a number of transactions are in the process of being completed with international banks (with or without the involvement of the Bank).

Since the warehouse receipts are now becoming increasingly common in Kazakhstan, the Bank is actively looking to expand the system through the creation of a market information system (pending availability of technical assistance funds) and hopefully, in the near future, enable the trading of warehouse receipts. For the larger countries in the Bank's countries of operations, i.e. Kazakhstan, Russia and Ukraine, the Bank is intending to play an active role in establishing trading mechanisms and rules and over time the Bank intends to facilitate the creation of some form of regional commodity exchange between those countries and smaller countries in the region being able to join on an ad-hoc basis.

Ukraine

In January 2002, a Memorandum of Understanding (the "MoU") between the Government of Ukraine and the EBRD was signed whereby the parties expressed intentions to co-operate in the implementation of a viable WHR system. On 4 July 2002 the Law on Grain and Market of Grain in Ukraine (the 'Law') was passed by the Parliament of Ukraine. The Law relates primarily to the regulation of the grain market and the Government's role but it also includes provisions for the creation of a WHR system.

Since the Law was passed in Parliament, the EBRD has continuously worked on securing funding for the implementation of the Law. Because of initial lack of availability of technical assistance funds, the programme was broken down into modules which were then financed on a stand alone basis: (i) the inspection agency module (USD 62,000), (ii) the indemnity fund module (USD 60,000) and (iii) the legal assistance module (USD 27,500) were financed with funding from USAID's Advisory Fund via the Bank. The regulatory body module (USD 100,000) was funded directly by USAID Kiev.

Despite the progress during the past 12 months in establishing the legal and institutional frameworks to support WHR systems, the system is only expected to become operational for the 2004/2005 harvest. The remaining secondary legislation required to support the WHR system must still be finalised, the credit guarantee system and oversight body (i.e. Inspection Agency) must be created, and system users (warehouse operators, traders, commercial banks and farmers) must be trained. Nevertheless the government is expediting the implementation of the WHR system and is launching the temporary certification of grain warehouses in the current year. Furthermore, the Bank has received a grant of nearly USD 900,000 from USAID to finalise the

implementation of the WHR programme. The Bank is currently in the process of selecting the consultants who will be responsible for finalising this work

The Bank expects warehouse receipts to become fully operational for the 2004 harvest, and is currently actively screening potential transactions, which could assist in testing and utilisation of the new instrument, once created.

Russia

The Bank started working on the Russian warehouse receipt legislation, in co-operation with the Russian Ministry of Agriculture, already in 2000, where a warehouse receipt law was drafted. Unfortunately the law has been stuck in the approval system ever since.

Irrespective of the progress on the legislation, because of the importance of the Russian agricultural market, the Bank has decided to start co-operating with the Russian Grain Union. The idea is for the Russian Grain Union to implement a 'private' WHR system based on several provisions within the Russian Civil Code. The Bank, Denton Wilde Sapte³³, and its consultant are actively participating in the working group established by the Russian Grain Union, and the Bank is in the process of seeking potential technical assistance donors for this effort. The intention would be to create a fully fledged WHR system, which could be handed over to the Russian Ministry of Agriculture once the necessary legislation has been passed in a manner satisfactory to the Bank.

Croatia

The Bank has reviewed a number of draft laws for warehouse receipts and the Croatian Ministry of Agriculture is actively working on the introduction of the legislation. However, the Bank has managed to start lending against agricultural commodities in Croatia using fiduciary transfer of property as a security instrument. The main expected benefits from the introduction of warehouse receipts in Croatia will be the licensing of warehouses and creation of an indemnity fund.

Serbia

The Bank has had initial discussions with the Serbian Ministry of Agriculture, regarding the implementation of the warehouse receipts law. The Minister of Agriculture (with whom the Bank had established a good working relationship) resigned earlier in the year and the Bank is now actively seeking to re-establish its contacts with the Serbian officials.

Moldova

Following discussions between the Bank and Moldovan government representatives during the Bank's AGM in 2003, the Bank visited Moldova and analysed the potential for warehouse receipts. The Prime Minister of Moldova agreed with the Bank's findings and the Moldovan Ministry of Agriculture has been given the task of preparing a draft of WHR law.

³³ Denton Wilde Sapte, is the Bank's main legal services provider under the Agricultural Commodity Programme. In connection with the effort in Russia, Denton Wilde Sapte has offered to assist on the legal side on a pro-bono basis.

Moldovan Draft Law on Grain Storage Certificates

For the goal of implementing the legislation on agricultural storage certificates, facilitating the funding of private grain producers with working capital and developing a stable and transparent grain market, the Parliament adopts the present special organic law.

Chapter I

General Provisions

Article 1. *The Object of the Regulation*

The object of the present special organic Law (hereinafter – *present Law, this Law*) shall be the legal framework for legalization of relations regarding the issuance, circulation and termination of agricultural storage certificates, regulation of the rights and obligations of the parties involved in such relations as well as regulation of the activities of warehousemen and other subjects of the aforementioned relations regarding storage, safekeeping and restitution of grains.

Article 2. *Basic Terms*

The following basic terms shall be used for the scope of the present Law:

- *agricultural storage certificate* – warehousing receipt (document) representing a security issued by the warehouseman in the name of the grain depositor in exchange for grain received from the latter (hereinafter – *storage certificate*);
- *storage* – a building, a group of buildings, including silo, as well as adjacent technical endowment situated on one premises, owned or managed by a legal entity and designed especially for the safekeeping of grains;
- *grain storing* – a service-type of activity rendered at the storage including reception, conditioning, safekeeping and restitution of grains;
- *warehouseman (storage keeper)* – a legal entity working for the goal of making a profit and having a special permit (license) offering the right to conduct the activity of grain storage and provision of storing services;
- *grains* – seeds of grain, leguminous, and oil-making crops and other seeds used for human and animal consumption, as well as for industrial and marketing purposes;
- *conditioning of grains* – cleaning, drying, threshing, aeration and other technological procedures aimed at bringing grain quality in compliance with the requirements of normative documents;
- *grain sample* – sample taken from a lot by means of one procedure and from one place;
- *storage regulation* – a document that must ensure recordkeeping of grains delivered and received for safekeeping in exchange for storage certificates, recordkeeping of storage certificates and other issued or terminated storage documents, as well as recordkeeping of

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the conditions of grain storage and conditioning in conformity with the Law and other normative statutes;

- *storage registry* – a system of entries reflecting the recordkeeping of grains received for safekeeping, as well as recordkeeping of issued or terminated storage certificates. The storage registry includes the registry of storage certificates and other storage documents, as well as the registry of grains received for safekeeping.

Article 3. *Legislation on Storage Certificates*

- (1) In the Republic of Moldova the relations regarding storage certificates shall be regulated by the Civil Code, the Law on Licensing Some Types of Activities, the present Law, and by other legislative and normative statutes, taking into account the specifics established in the present Law.

- (2) In case of discrepancies between a norm of the present Law and a norm of other general legislative or normative statutes having a similar legal power, the norm of the present Law shall be applied.
- (3) Should an international treaty to which the Republic of Moldova is a party stipulate provisions other than those embodied in the present Law, the provisions of the international treaty shall be applied.

CHAPTER II **WAREHOUSERS**

Article 4. *Warehouser's Status*

- (1) Pursuant to this Law, warehouseurs can only be legal entities operating in this field, registered in compliance with the legislation of the Republic of Moldova under a legal form provided for by the Law.
- (2) The warehouseur cannot carry out the storing activity concurrently with other activities, other than those allowed by law.
- (3) The warehouseur's storage shall have a storing capacity of at least 1000 tons.

Article 5. *Warehouser's Rights and Obligations*

- (1) The warehouseur shall have the following obligations:
 - a) observe the manner of grain reception and conditioning, as well as the rules ensuring quality and quantity maintenance in conformity with the provision of valid normative statutes;
 - b) make sure that grain owners and control bodies take grain samples in the established manner, if needed;
 - c) fully retribute the grains kept in conformity with contract provisions at the first request of the storage certificate holder and in exchange for the storage certificate, except for the cases provided in this Law and provided that the storage certificate does not indicate any pending debts related to grain storage;
 - d) publish the annual balance sheet and income statement in mass media within a month from the deadline for their submission to tax authorities.

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- (2) The warehouseur shall be entitled to:
 - a) compensation of storage related costs in cash or by holding back a certain amount of stored grains;
 - b) compensation of other costs related to activities carried out in the interest of the storage certificate holder provided in the contract or established by legislative or normative statutes.

Article 6. *Warehouser's Audit and Reports*

- (1) The warehouseur shall undergo a mandatory annual audit inspection to verify and confirm the accuracy of his/her economic and financial activity.
- (2) The control over the warehouseur's activity and his/her management bodies by the audit commission (auditor) shall not exempt the warehouseur from an audit inspection.
- (3) The list, forms and terms of recordkeeping and submission of reports on meeting qualification requirements set for the warehouseurs' grain storage activities shall be

established by the Ministry of Agriculture and Food Industry together with the Statistics and Sociology Department.

Article 7. Restrictions in the Warehouser's Activity

- (1) The warehouser shall not have the right to practice activities not related to grain storage, including serve as guarantor and/or collateralize his/its goods as security of third party obligations, except for the following activities:
 - a) production and marketing of farinaceous foods, mixed fodder, bakery foods and
 - b) provision of oil product and solid fuel storage and safekeeping services.
- (2) The warehouser's buildings used for the activities mentioned in item (1) must be technologically connected to the warehouse and/or be located on the same ground or on a ground adjacent to the warehouse.
- (3) The warehouser shall be obliged to ensure separate recordkeeping of activities related to grain storage and activities that are not related to grain storage.

Article 8. Regulation on Storage

- (1) The warehouser operating under this law and other legislative and normative statutes shall be obliged to approve the regulation on grain storing activity (hereinafter – storage regulation).
- (2) The storage regulation and all amendments and additions to it shall be registered with the Ministry of Agriculture and Food Industry and shall be made available to any interested person constituting no commercial secret.
- (3) Amendments and additions made by the warehouser to the storage regulation during the term of the storage contract, except for amendments and additions derived directly from the provisions of legislative and normative statutes subsequent to laws, shall be applied in relation to the respective depositor (customer) only upon expiration of the storage contract, unless the latter stipulates otherwise.
The sample regulation of the warehouser's storing activity shall be approved by the Government.

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Article 9. Warehouser's Licensing

- (1) To carry out the storing activity, the warehouser shall be certified as established by the Law on the basis of a storage license issued in its/his name. The storage license can be issued provided that the financial, technical and other conditions are observed. Storage licenses will be issued by the Licensing Chamber.
- (2) Verification and certification of the financial, technical and other conditions will be done by the Ministry of Agriculture and Food Industry through the State Inspection for Cereal and Bakery Foods or through other specialized legal entities authorized for this purpose in the established manner.

Article 10. Term of Validity of the Storage License

- (1) The storage license shall be issued for a five-year period from the date of its issuance.
- (2) If the warehouse intends to carry out storing activities after expiration of the license validity term, it will have to get a new license, issued not earlier than the last business day of the previous license validity period.

Article 11. License Fee

- (1) Storage license shall be issued against a fee for license issuance which shall be transferred to the state budget.
- (2) The amount of storage license issuance fee shall be established annually through the Budget Law.

Article 12. Terms of License Issuance, Suspension, Annulment or Withdrawal

- (1) The terms of storage license issuance shall be established by the Government.
- (2) The storage license may be suspended, annulled or withdrawn by the empowered body in conformity with the provisions of this Law and the Law on Licensing Some Types of Activities.
- (3) Should there be a proposal for suspension or annulment of the storage license, the warehouse shall be entitled to a hearing on the reasons that served as ground for such a proposal.
- (4) Representatives of the Ministry of Agriculture and Food Industry shall exercise control of the storage where a violation of storing conditions was identified, and the warehouse will carry this activity till settlement of all obligations resulting from the contracts signed with customers.
- (5) In case of storage license suspension, annulment or expiration, the warehouse shall be obliged to deliver to the Ministry of Agriculture and Food Industry the storage certificates annulled as a result of grain restitution to the depositor, the storage certificates completed incorrectly and the unfilled ones.

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Article 13. Storage Tariff

- (1) The payment for storage services shall be made in cash or in kind, the counter value of the in-kind payment shall be calculated at the market price fixed at the time of storage contract signing.
- (2) The negotiated period for prepaid storage services shall not exceed 12 months. If the storage period exceeds the negotiated period, the depositor will pay the warehouse's customary tariff at the date of grain restitution to cover the period exceeding the term provided in the contract.
- (3) The warehouse shall permanently make the tariff for storage services visible by placing it on boards designed for public relations.

Article 14. Reception of Grains for Storage

- (1) When receiving grains for storage the warehouse shall act in compliance with the provisions of the regulation, of the contract on service provision signed with the depositor and with the norms of the valid legislative and normative statutes.

- (2) The quality and value of stored grains shall be determined through the parties' agreement. The value determined and indicated in the contract on service provision shall serve as basis for insurance contracts and remedy claims related to the grains delivered for storing.
- (3) Prior to signing the contract on service provision the warehouseer shall have the right to assess on his own the quality of grains to be stored.
- (4) If the grain depositor disagrees with the results of the evaluation made by the warehouseer, he/she may perform an independent grain expertise through a special empowered organization.
- (5) If the independent expertise results match the quality features of the grains declared by the depositor, the warehouseer shall cover the customer's costs incurred in relation with the independent expertise.
- (6) If the quality features of the grains determined as a result of the independent expertise will be lower than those declared by the depositor, the warehouseer shall have the right to decline acceptance of grains till these features are negotiated and coordinated with the customer.
- (7) In the scope of the present law, no contract on service provision shall be signed on unharvested grains, as well as on grains seized or otherwise penalized in conformity with the valid legislation.

Article 15. *Insurance*

- (1) The warehouseer shall be obliged to sign an insurance contract on the grains stored in conformity with the storage certificates against natural and risk factors or insure its civil accountability before the holders of storage certificates issued by the former.
- (2) Insurance contracts shall be signed against the following risks: explosions, fires, floods, earthquakes and theft.
- (3) Part of insurance premiums shall be paid from the Guarantee Fund for Storage Certificates in the amount and manner established in the Fund Charter.
- (4) The right to indemnity resulting from contracts on grain insurance or insurance of civil accountability before storage certificate holders on the basis of a relinquishment contract shall be fully transferred to the Guarantee Fund for Storage Certificates.

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Article 16. *Safekeeping of Grains*

- (1) The warehouseer will keep the grains separately depending on the quality registered on each issued storage certificate so that the quality of restituted grains corresponds to the quality of the grains upon reception.
- (2) Throughout the grain storage period losses and outages shall be determined in conformity with the norms established by valid normative statutes.
- (3) The warehouseers providing grain storage services shall be obliged to accept the grains delivered for storage in a non-discriminatory manner, up to the maximum capacity for which the storage license is issued.

Article 17. *Storage Registry*

- (1) The warehouseer shall be obliged to keep a storage registry separate from other recordkeeping documents and warehouseer's registries.
- (2) The Regulation of the storage registry shall be approved by the Government.

- (3) The storage registry may be kept on paper or electronically. The warehouse shall be obliged to appoint the person(s) responsible for keeping the storage registry.
- (4) The storage registry shall include the registry of storage certificates issued to customers and the registry of grains received for safekeeping (hereinafter – grain registry).

Article 18. Registry of Storage Certificates

- (1) The following entries shall be made in the registry of storage certificates upon issuance of a storage certificate to a depositor:
 - a) number of the certificate issued from the registry of storage certificates;
 - b) serial number of the blank form where the storage certificate is written;
 - c) date of storage certificate issuance;
 - d) description of grains received for storing, identical with the one mentioned in the storage certificate;
 - e) first and last name of the person from which grains are received for storing and his/her location (home address);
 - f) all other data on the storage certificate except for the warehouse's signature and stamp.
- (2) Entries in the registry of storage certificates shall be made separately for each issued storage certificate. When an entry is made, the date of the entry shall be indicated along with the signature of the responsible person authorized to make the entries and of the depositor.
- (3) Upon termination of the storage certificate due to restitution of grains to the owner, an entry shall be made in the registry of storage certificates and the date of certificate termination shall be indicated.
- (4) Upon sale of grains at the request of the collateral coupon holder, an entry shall be made in the registry of storage certificates confirming termination of the respective part of the storage certificate in relation to its sale, specifying the certificate termination date.
- (5) Upon termination of storage relations in case when the shelf life has expiration while the storage certificates have not been returned to the warehouse and the grains stored have not been claimed yet, an entry shall be made in the registry of storage certificates explaining the actions taken in regard to the given grains.

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- (6) In case of changes in storage conditions and in the mandatory data specified in the storage certificate, an entry shall be made in the registry of storage certificates regarding the conditions of storage or the amended data.
- (7) In case of loss of the storage certificate a special entry about this loss shall be made in the registry of storage certificates specifying the reason for the entry.
- (8) The registry of storage certificates may also include other information about storage certificates issued by the warehouse.
- (9) The information included in the registry of storage certificates shall be considered confidential and constitute a commercial secret of the warehouse. Information from the registry of storage certificates about the entries made in relation to the respective storage certificate shall be provided at the request of the storage certificate holder or the collateral coupon holder.

Article 19. Grain Registry

- (1) The registry of storage certificates shall have separate entries by varieties of grains received for storage according to each storage certificate issued or according to other storage documents.
- (2) If several storage certificates of the same type with similar document entries and for the same variety of grains are issued to the depositor, one entry shall be made in the registry with indication of the numbers of all storage certificates.
- (3) The grain registry should contain:
 - (3) serial number of the blank form used to fill out the storage certificate;
 - (4) numbers of storage certificates according to the registry of storage certificates;
 - (5) quantity and qualitative features of the grains received for storage according to the storage certificate issued as well as the value of these grains;
 - (6) changes in the grains features which might occur throughout the storage period, should such a possibility exist;
 - (7) other information on the grains received for storage.

Article 20. *Control over the Warehouser's Activity*

- (1) The representatives of the Ministry of Agriculture and Food Industry are authorized to examine all warehouser's registries, logs, statements, documents and accounts related to its grain storing and safekeeping activities.
- (2) Unscheduled inspections of the warehouser may be performed on a case-by-case basis in order to ensure their ongoing compliance with the license conditions and to verify if the quantity of grains indicated in the storage certificates issued coincide with the physical amount of the grains kept in storage.
- (3) Upon the express request of the Ministry of Agriculture and Food Industry the warehouser shall be obliged to transfer information and/or reports about storage and safekeeping of grains.
- (4) Dissemination or transfer of information obtained during the warehouser's activity inspection to third parties by persons carrying out these inspections shall be prohibited.

Article 21. *Grounds for Warehouser's License Suspension*

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- (1) The warehouser's license on the right to carry out grain storage activity shall be suspended if the grounds provided in other legislative statutes along with the listed below are proved:
 - (a) non-fulfilment of the obligations resulting from the storage contract and/or storage certificate;
 - (b) violation of phytosanitary norms established in the legislation and other normative statutes;
 - (c) violation of the provisions of normative statutes or non-fulfilment of the written instructions regarding the warehouser's storage activities issued by the Ministry of Agriculture and Food Industry or the State Inspectorate for Cereal and Bakery Foods within their scope of authority as well as prevention from free access of the representatives of the given bodies into the storage premises;
 - (d) performance of activities prohibited or limited for the warehouser;

- (e) repeated identification (two or more times throughout 6 calendar months) of cases of distortion of data about the quantity and quality of grains received or restituted;
- (f) non-extension of insurance contracts securing both the warehouse and the grains stored against natural or risk factors;
- (g) failure to store the grains for which storage certificates are issued in the warehouse backed by license;
- (h) failure to make contribution to the Guarantee Fund for storage certificates as stipulated in article 33, item (4) of this Law;
- (i) failure to fulfil the requirement of mandatory annual audit inspection,

Article 22. *Grounds for Storage License Withdrawal*

The warehouseer's license on the right to carry out grain storage activity shall be withdrawn in case the grounds provided in other legislative statutes along with the following motifs are proved:

- (a) violation of the technical and/or financial conditions by the warehouseer and intentional conveyance of erroneous data and information on enforcement of the given conditions;
- (b) court-issued interdiction to get engaged in grain storage activities;
- (c) issuance of storage certificates for a quantity of grains surpassing the storage capacity specified in the license;
- (d) refusal to retribute the grains entered in the storage certificate according to the quality specified in the latter. The quantity of grains the value of which is equal to the value of unpaid storage costs shall not be regarded as refusal;
- (e) deficiency of grains in the possession of the warehouseer subject to have been kept in the warehouse according to the storage certificate data.

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Chapter III
Storage Certificate

Article 23. *Issuance of Storage Certificates*

- (1) The storage certificate shall be issued in the form of a special document, which is assigned a serial number by the Ministry of Agriculture and Food Industry and made available to the warehouseers.
- (2) The storage certificate shall consist of two parts – warehouse receipt and collateral coupon which, if needed, can be separated from each other. The storage certificate and each of its parts shall be considered as unissued bearer's securities.
- (3) The Ministry of Agriculture and Food Industry shall order the printing of storage certificates and keep records of the latter.
- (4) The printing of storage certificates shall be funded from the state budget, through the budget allocated to the Ministry of Agriculture and Food Industry.

- (5) The warehouse requesting storage certificates will pay the equivalent value of the latter on the date of their receipt.

Article 24. *Issuance of Storage Certificates by the Warehouse*

- (1) Based on the contract for service provisions signed in writing, the warehouse shall issue storage certificates to the depositors for the grains delivered by the latter and placed for storage in compliance with the Law provisions for a maximum period of 12 months.
- (2) The written form of the contract for service provisions shall be considered as observed even in case when the reception of grains is confirmed through issuance of a storage certificate.
- (3) The contract on provision of services will include storage conditions and terms, the value of stored grains, tariffs for storage and other services, the quantity and quality of stored grains, as well as the rights and obligations of the parties.
- (4) The value of the stored grains shall be established based on the parties' consent. The value fixed and entered in the service provision contract shall serve as basis for insurance contracts and indemnity claims related to the grains delivered for storage.
- (5) The storage certificate shall be issued for at least 5 tons of grains confirming the following:
 - (a) ownership title over the grains;
 - (b) unconditional obligation of the warehouse to deliver the grains indicated in the storage certificate at the first request of the title holder or at any pre-determined moment in the future;
 - (c) the right of the creditor-pledgee in relation to the grains in case the latter is used as collateral.
- (6) Once the total amount of grains is received by the warehouse, at the customer's request, it shall issue one or several storage certificates on portions of the total bulk, and shall cancel the initial certificate if the latter has been previously issued. The storage certificate shall be issued within the deadline fixed by the customer, but not later than 3 working days from the day of grains reception for storage.
- (7) Storage certificates shall be issued in the name of grain owner and recorded in the Registry of storage certificates against the signature of the latter. Entries shall be kept in chronological order by the warehouse.
- (8) Issuance of storage certificate listing grains of different varieties, quality and price shall be prohibited.
- (9) The warehouse shall cancel the storage certificates that are inappropriately completed. The counter-value of the certificates issued to replace the cancelled ones will be paid by the party found liable of the errors committed upon certificate completion.

Article 25. *Sample Storage Certificate Form*

- (1) Sample storage certificate shall be approved by the Government.
- (2) Each part of the storage certificate issued in accordance with the provisions of this Law shall contain the following:
 - a) number and serial number of the blank form to be used for entering the storage certificate;
 - b) warehouse's name and location, storage license number, state identification number, tax identification code;
 - c) record number of the storage certificate as entered in the warehouse's registry;

- d) customer's identification data (name, location, state identification number and tax identification code of the legal entity; or first and last name, residential address, tax identification code of the natural person/individual) and its/his signature;
 - e) type, harvesting year, class, quality and quantity of delivered grains, as well as the value of the grains stored;
 - f) period of grain storage;
 - g) tariff set for the services provided and, if needed, value of prepaid services;
 - h) date of storage certificate issuance;
 - i) a section on transfer of the title of property over the storage certificate, as well as on setting up the collateral for the grains stored;
 - j) signature and seal of the warehouse.
- (3) The document inconsistent with the requirements set forth in the mandatory contractual clauses will not be certified by the warehouse.
- (4) The warehouse shall submit to the Ministry of Agriculture and Food Industry the list of persons empowered to sign storage certificates, specimen with their signatures, as well as print sample of the seal stamped on the storage certificate.

Article 26. *Circulation of Storage Certificate*

- (1) Storage certificate shall be transferred without any limitations or restrictions.
- (2) Storage certificate shall represent the writ of execution for the quantity of grains specified in it.
- (3) Storage certificate shall be considered valid until the date of grain restitution by the warehouse, but no longer than 12 months from the date of its issuance.
- (4) To store the grains beyond the negotiated time-frame, the warehouse shall issue a new storage certificate.

Article 27. *Making Entries in the Storage Certificate*

- (1) The rights over the storage certificate shall be transferred through endorsement. Endorsement shall be made in the state language and contain the following:
 - a) full name (first and last name) of the endorsee and endorser;
 - b) signature of the endorsee (representative of the endorsee - legal person) and, if needed, application of the seal;
 - c) date when endorsement is made.
- (2) The endorsement stroke out or erased shall be considered non-entered. The endorsement can not be conditioned in any way. Any clause limiting it and any additions or indications spelled on the endorsement shall be considered as non-documented.
- (3) If the collateral coupon is not cut up from the warehouse receipt, endorsement shall be made on the warehouse receipt only.
- (4) When cutting up the collateral coupon from the warehouse receipt, the following information shall be mentioned on both sides of the storage certificate:
 - a) name and location of the endorser – for legal entities, or first/last name and residential address of the endorser – for natural persons;
 - b) the purport of the collateral-backed debenture, its value and related interest, as well as maturity date;
 - c) signature of the creditor-pledgee on the warehouse receipt, and signature of the endorsee on the collateral coupon;
 - d) date of cutting up the collateral coupon.

Article 28. *Recordkeeping of Storage Certificates*

- (1) The Ministry of Agriculture and Food Industry shall record the storage certificates printed and distributed to warehouses in a special registry of storage certificates.
- (2) The warehouse shall make complete entries in its own registry about storage certificates issued, cancelled or left blank, as well as the grains stored in the warehouse.
- (3) The registries and storage certificates will be kept in metal vaults placed in premises endowed with maximum security.

Article 29. *Cancellation of Storage Certificates*

- (1) Storage certificates shall be cancelled by the warehouse when the grains are returned to the storage certificate holder and if no claims regarding the quantity and quality of grains are laid.
- (2) The warehouse shall cancel the storage certificates from which the collateral coupon has been cup up only once grains are returned to the storage certificate holder and provided that the latter repaid the outstanding sum for the given collateral coupon.
- (3) Within three days from restitution of grains to the holder, the warehouse shall cancel the storage certificate by applying a seal with the mark “cancelled” and indicating the date of cancellation, and shall make the respective mentioning in the Registry of Storage Certificates.
- (4) The cancelled storage certificates shall be withdrawn from the certificate holder by the warehouse and no repeated distribution shall be allowed.

Article 30. *Expiration of Storage Certificates Validity*

- (1) Storage certificate validity shall have expired upon reaching the term for which it is initially issued.
- (2) If upon expiration of the storage certificate validity its title holder wants to sign a new contract for storage service, the warehouse shall then withdraw the old certificate and issue a new certificate for a new term. This transaction cannot take place if the certificate

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- (3) has been pledged while the warehouse receipt holder does not present the relevant collateral coupon.

Article 31. *Duplicate Storage Certificate*

If the storage certificate is lost, stolen or damaged, its holder will declare the respective title null and void through the Official Gazette of the Republic of Moldova and will notify the warehouse requesting issuance of a new storage certificate. The warehouse shall issue a duplicate certificate within 5 days from the announcement publication in the Official Gazette of the Republic of Moldova.

Chapter IV
Storage Certificate Holders

Article 32. *Rights of Storage Certificate Holders and of Its Parties*

- (1) The holder of both parts of the storage certificate or holder of the warehouse receipt stripped from the collateral coupon shall be entitled to use the storage certificate or the warehouse receipt as real distinct titles. The holders shall have the right to use them in negotiation of legal documents, including through stock exchanges or in any other ways provided by the law taking into due account the restrictions established by the legislation on securities and this Law.
- (2) The holder of both parts of the storage certificate shall be entitled to dispose of the stored grains in its total amount as indicated in the storage certificate. In such a case, grains shall be transferred through relinquishment of the storage certificate.
- (3) The holder of the warehouse receipt stripped from the collateral coupon shall be entitled to use the grains kept in the warehouse. In such a case grains are transferred by making over the warehouse certificate stripped from the collateral coupon, but the warehouse receipt holder shall not be entitled to request restitution of grains by the warehouse till the indebtedness secured through the pledge of the collateral coupon is settled under the established procedure.
- (4) Transfer of the ownership title over grains confirmed through the transfer of the storage certificate without the receipt of the grains from the warehouse shall not conduce to the appearance of any tax obligations. Taxpayers income received from the operations involving storage certificates shall be taxed in conformity with the legislation on taxation of transactions with securities.
- (5) Should the collateral coupon holder and its/his place of location be known to the warehouse receipt holder, in order to ensure restitution of grains the warehouse receipt holder will be able to pay the collateral coupon holder a sum equal to the value of the collateral-backed indebtedness and the related interests, as well as to request the return of the collateral coupon by its holder.
- (6) Should the collateral coupon holder be missing and/or its/his place of location be unknown, the warehouse receipt holder shall be entitled to transfer onto the warehouse's account a sum equal to the value of the collateral-backed indebtedness and its related interests, as well as to request issuance of a receipt reflecting the transferred amount.
- (7) The holder of the collateral coupon stripped from the warehouse receipt shall be entitled:
 - (a) to request that the person who stripped the collateral coupon from the warehouse receipt settle the indebtedness confirmed by the collateral coupon and the related interests;

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- (b) to transfer the collateral coupon and the related rights to a third party.

Article 33. *Storage Certificates and Grains Encumbrance through Collateral*

- (1) Storage certificate and warehouse receipt may serve as independent objects to be used as collateral. In that case, upon fulfilment of collateral rights the pledge-backed securities representing the object of collateral shall be subject to action and sold under the procedure established by the existing legislation.
- (2) In order to get hold of the warehouse receipt, its holder does not need the consent of the collateral coupon holder.
- (3) Grains delivered for storage against storage certificates may serve as an object of collateral. To do that, the collateral coupon shall be stripped from the warehouse receipt and transmitted to the creditor-pledgee with a respective entry made on the collateral coupon. In such a case, upon fulfilment of collateral rights the stored grains will become an object of legal action and sold following the procedure established in the current legislation and with due account of the specifics of this Law.
- (4) Remittance of the collateral coupon to the creditor proves the constitution of collateral for the quantity of grains specified in the respective section of the storage certificate. The

collateral coupon shall be stripped in compliance with the provisions of article 27, item (4) of this Law.

- (5) Within 5 days after the establishment of the collateral, the creditor shall notify the warehouse – issuer of the storage certificate. Once the creditor-pledgee’s notification is received, the warehouse should make respective entries in the Registry of storage certificates issued. The warehouse will reconstitute the quantities of grains specified in the storage certificate only in case the latter is accompanied by the collateral coupon.
- (6) To constitute new collateral the storage certificate holder shall request issuance of a new storage certificate by the warehouse, being required to return the collateral coupon issued earlier.
- (7) If at maturity date the warehouse receipt holder failed to pay the collateral coupon holder the amount indicated in the collateral coupon and the related interests or has not transferred it to the warehouse’s account, the grains specified in the collateral coupon shall be subject to legal actions at the request of the creditor-pledgee.
- (8) Grains shall be subject to legal actions provided that the following cumulative reasons exist:
 - a) failure to timely fulfil the obligations before the collateral coupon holder by the warehouse receipt holder;
 - b) failure to transfer the payable amount onto the account of the warehouse;
 - c) expiration of the debt repayment term specified in the collateral coupon;
 - d) written request of the collateral coupon holder;
 - e) lack of a written declaration of the collateral coupon holder on debt repayment;
 - f) existence of the right of the collateral coupon holder over the pledge-secured indebtedness and availability of documents confirming the given entitlement.
- (9) Having received the collateral coupon holder’s request to institute actions in relation to the grains, the holder of the warehouse receipt stripped from the collateral coupon shall not be entitled to request restitution of the grains from the storage.

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Chapter V

Storage Certificates Guarantee Fund

Article 34. *Creation of the Storage Certificate Fund*

- (1) The Guarantee Fund for storage certificates (hereinafter – the Fund) shall be created on the date this Law comes into effect.
- (2) The Fund shall be registered as a public legal entity supported from extra budget funds and other sources.
- (3) The Fund’s organization and functioning shall be based on its own Charter approved by the Government following the request of the Ministry of Agriculture and Food Industry.
- (4) The warehouses that received storage licenses should contribute a share to the Fund’s account in an amount equal to two conventional units for each ton of the warehouse’s total capacity for which the license is issued.

Article 35. *Goal of the Fund*

- (1) The goal of the Fund shall be to guarantee repayment of the value of grains specified in the storage certificates issued by the warehouse owners that received storage licenses and to repay the warehouse owners the amount representing the equivalent (counter) value of the stored grains when the warehouse owners are not available.
- (2) In case of the warehouse owner's non-availability, storage certificate holders will receive the equivalent value of the grains listed in the storage certificate calculated at the market price as of the date of the request for restitution of grains.
- (3) Within 30 days from the date of depositors' notification, the Ministry of Agriculture and Food Industry will proceed to the establishment of financial losses resulting from non-availability of the storage certificate.
- (4) Within 30 days from defining the amount of losses, the Fund will repay the damage to the depositors according to the provisions of this Law and the Fund's Charter.

Article 36. Financial Resources of the Fund

- (1) Warehouse owners should participate in the creation of the financial pool of the given Fund in order to ensure the financial interests of the fund depositors (i.e. warehouse customers).
- (2) Contributions to the Fund's budget will only be used for protection of financial interests of the customers that deposited their grains in case when the warehouse owners are not available to meet the obligations stipulated in the storage services' contract and to reconstitute the grains upon the customer's request or their counter value.
- (3) Financial resources of the Fund's income and expenditure budget shall comprise the following:
 - a) share contributions paid by the warehouse owners representing an amount equal to two conventional units for each ton of the warehouse's total capacity for which the license is issued;
 - b) interest rates collected of the deposits created by the Fund;
 - c) payment of the Fund's receivables;
 - d) collection of indemnities from insurance policies to the contracts envisaged in article 15;
 - e) revenues from investment of Fund's resources;
 - f) other income not prohibited by the law.

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- (4) Financial resources provided in item (3), letter e) will be used to cover the direct costs of the Fund.
- (5) The minimum and maximum ceiling of the Fund's resources used to endorse the equivalent value of the grains kept in the warehouse shall be **yearly** established by the Government.
- (6) The amounts representing participation shares and thus contributed upon the Fund's creation shall not be reimbursable.
- (7) Current expenses of the Fund can not surpass the income provided in item (3), letter e).

Chapter VI
Fulfilment of the Storage Certificate

Article 37. Storage Certificate Fulfilment Procedure

Storage certificates shall be fulfilled under the following procedure:

- a) the storage certificate holder informs the warehouse owner of his instruction to reconstitute the stored grains at any moment of the storage certificate validity.

- b) within no more than 3 working days from the day of restitution instruction notification, the warehouse shall return the grains in the sequence of restitution requests received from other certificate holders, which will depend on the warehouse loading capacity and its endowment with technical means;
- c) if the storage certificate holder did not pay the storage fees to the warehouse, fulfilment of the grains-related liabilities is ensured according to the provisions of the contract on provision of services concluded between the parties;
- d) if the storage certificate was prepared at the request of the creditor-pledgee following the submission of the collateral coupon, the storage certificate holder will receive the eventual outstanding difference remaining after settlement of the payable amount by the creditor-pledgee and after withdrawal of the equivalent value of grains' storage and safekeeping expenses by the customer-depositor;
- e) the warehouse's duty is to store grains until the moment when the creditor-pledgee orders their utilization to recoup the debts, but not later than 30 days after expiration of the storage certificate validity. Damage resulting from suspension of delivery and additional costs associated with storage of grains shall be covered out of the proceeds collected from their sale;
- f) if grains are sold through tender, on the date mutually agreed with the warehouse the highest public tender bidder who adjudged the given goods in his favour (hereinafter – purchaser) shall come to the shipment chamber of the warehouse to load the commodities;
- g) vehicles for the given cargo shall be provided by the purchaser of the grains stored;
- h) the quality and quantity of the grains delivered to the purchaser should correspond to the data mentioned in the storage certificate.

Article 38. Procedure of Collateral Coupon Fulfilment

- (1) If the warehouse receipt holder settles the amount payable to the creditor prior to the maturity date for the liability indicated in the warehouse receipt, the collateral coupon holder should make an endorsement on the warehouse receipt and forward the collateral coupon to the warehouse receipt holder.

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- (2) In case of non-fulfilment or inappropriate fulfilment of the liability confirmed by the collateral coupon, the collateral coupon holder shall be entitled to start legal actions in relation to the grains indicated in the collateral coupon.
- (3) If in the process of legal actions grains are requested for restitution by the warehouse receipt holder and the warehouse is given proof of the fulfilment of the obligation secured by pledge and the related interest, the collateral coupon holder shall be then obliged to return the collateral coupon to the warehouse for its settlement.

Article 39. Sale of Gains Placed under Action

- (1) Upon expiration of 10 working days after the pledge-backed liability maturity date, collateral coupon holder shall be entitled to present the collateral coupon to the warehouse along with the request to sell the pledged grains.
- (2) Within 20 working days after receipt of the collateral coupon holder request but not later than 5 working days prior to the tender, the warehouse shall make an announcement on sale of grains secured by collateral through a public tender. The public tender notice shall be made by the organizer of the tender through mass-media. The warehouse is

entitled to empower a commodities exchange or another agent with organization and performance of a tender for sale of grains secured by collateral.

- (3) Grains secured by collateral on the basis of a collateral coupon will be placed for sale only as a unity lot. Grains specified in a collateral coupon shall not be sold in parts.
- (4) The initial price of grains placed for sale shall be established in an amount equal to the initial value of the grains stored as specified in the storage certificate. If it is impossible to sell grains at their initial price, independent evaluation of the grains price shall be performed at the request of the creditor-pledgee and at its expense.
- (5) The proceeds received from sale of grains shall be distributed in the following sequence:
 - (a) first, withholding of the expenses associated with tender organization and performance;
 - (b) second, withholding of the amount payable to the warehouse for the storage of grains;
 - (c) third, settling the outstanding amount secured by collateral payable to the collateral coupon holder;
 - (d) transfer of the residual cash remaining after sale of grains to the warehouse receipt holder in exchange for the given receipt.

Article 40. *Fulfilment of Obligations in Case of Lack of Grains in the Warehouse*

In case the warehouse does not have any grains in his possession as listed in the storage certificate, the financial interests of the depositors-customers shall be ensured using the Guarantee Fund created to secure the storage certificates.

Chapter VII
Restitution of Grains

Article 41. *Warehouse's Grain Restitution Obligation*

- (1) The warehouse should reconstitute the grains according to the quantity and quality entered in the storage certificate.
- (2) Restitution shall be made provided that the storage certificate holder provides both the storage certificate and the collateral coupon.

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Article 42. *Restitution and Delivery of Grains*

- (1) At the request of the storage certificate holder and in exchange for the storage certificate, the warehouse should deliver the stored grains within 3 working days according to the quality and quantity conditions specified in the storage certificate. The latter however shall only be done once the due outstanding payment is covered to counterbalance the value of storage services calculated as of the restitution date.
- (2) Upon restitution of grains, the storage certificate holder will sign a statement confirming the receipt of the restituted grains and will prepare the waybill according to the provisions of the existing normative statutes.
- (3) The depositor is not entitled to request partial restitution of the quantity of the grains mentioned in the storage certificate.

Article 43. *Establishing the Quantity and Quality of Grains Pending Restitution*

- (1) The warehouse should determine the quantity and quality of grains to be restituted in the presence of the storage certificate holder or a representative nominated by the latter. Each

of the contractual parties shall also be entitled to request performance of an independent expert evaluation to identify the quality of grains. The costs associated with these actions will be covered by the party that requested the given expert evaluation, if the other party is not proved to have acted in bad faith.

- (2) In case of restitution of grains to the storage certificate holder after expiration of the validity term stipulated in the storage certificate or in case of restitution in favour of the highest tender bidders (purchasers), the warehouse is obligated to hand out a sealed proof sample to the grain possessor or his/its delegated representative for each transportation means. A second proof sample shall be kept by the warehouse during 30 days after complete remission of grain.

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Chapter VIII.

Temporary and Final Provisions

Article 44.

This Law shall come into effect 3 months after publication date except for article 45 which shall become effective upon publication.

Article 45.

(1) Within 3 months, the Government:

- (a) shall approve the Sample Regulations on the Warehouse's Storing Activity, the Conditions for Issuance of Storage License, the Regulations on the Storage Registry, Sample Form of Storage Certificates, the Charter of the Guarantee Fund for Storage Certificates;

(b) will bring all normative acts enacted by the Government in compliance with this Law.

Chairman of the Parliament
of the Republic of Moldova

Chisinau _____ 2004
No. _____ - XV

APPENDIX 5

EBRD Transition Report 2002
Agricultural and rural transition
The Warehouse Receipts Programme

Insufficient access to working capital is one of the key problems in the agricultural sector in transition countries. The use of warehouse receipts as a form of collateral has proven to be a simple and cost-effective way to overcome this problem and to provide financing to the agribusiness and farm sector. The basic mechanism of warehouse receipt based financing is described below (see chart).

At the time of harvest, farmers store their crop at a licensed warehouse, receiving a Certificate of Title (CT) and a Certificate of Pledge (CP). The warehouse will only release the crop to the owner of both documents except when the loan is defaulted. A national indemnity fund and regular inspections reduce the risk of damage or fraud while the crop is stored in the silo.

When farmers borrow against the crop, the bank keeps the CP as security and the CT for safekeeping. Before the maturity of the loan (typically up to nine months) the farmer sells the crop to a processor (or to a trader) by "selling" the CT following consultation with the bank. At

maturity of the loan or when it needs the crop, the processor redeems the CP from the bank by repaying the loan. The processor, now owner of both CT and CP, can collect the crop from the silo.

There are several advantages to financing based on warehouse receipts. The farmers can choose when to sell without being forced to sell at the time of harvest when prices are generally low. Their access to finance improves, which enables them to secure the supply of materials throughout the year. The risk of lending for banks is reduced by the availability of collateral that is relatively easy to liquidate, and this lowers the cost of financing available to the agricultural sector. Price fluctuations during the year are also generally reduced. The general condition of the storage sector can be expected to improve as the implementation of warehouse receipts requires tight regulation and inspections to reduce post-harvest losses of grain in the warehouses. Finally, government interference in the sector, such as price fixing, may be reduced as the system allows for more transparency and commercial financing. Ultimately, the system may lead to the development of commodity exchanges, including commodity futures, to further increase market transparency.

Since 1998, the EBRD has provided the equivalent of €87.5 million of working capital financing collateralised by warehouse receipts in Bulgaria, Kazakhstan and the Slovak Republic, which has the most extensive warehouse receipts programme in the region. The Slovak authorities passed a Warehouse Receipts Act in 1998 and soon after its adoption the EBRD, together with a local bank, started to provide financing backed by warehouse receipts. Between 1998 and 2001 the EBRD co-financed 340 sub-loans worth €16.5 million. Other Slovak commercial banks soon began to lend against warehouse receipts as well, enhancing both price transparency and competition in the agricultural sector. Competition in the storage sector also increased as quality control of grain inventories improved and warehouses were licensed. However, the lack of an indemnity fund and the continued provision of state subsidies to primary producers raise questions about the commercial sustainability and long-term future of the instrument.

Sources: Martin and Bryde (1999) and EBRD.

