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Business Regulatory, Investment, and Trade Environment Program (BRITE)

TRADE FACILITATION IN MOLDOVA

A CASE FOR CUSTOMS BONDS AND DEFERRED PAYMENT

DISCUSSION PAPER

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INTRODUCTION

As Moldova moves closer to European integration it has no choice but to continuously adopt the latest customs procedures, including the pre-arrival processing and release of goods and post-release audits. Customs administrators are obliged to release goods faster than before and increasingly rely on trade securities to complete transactions before a final audit or account reconciliation can occur. This means that it is in the interest of customs administrators to expand the range of financial guarantees they accept from individuals and economic operators, which will in turn increase revenue and facilitate trade.

The World Customs Organization (WCO) Revised Kyoto Convention guideline 3.4 states:

"If the Customs are satisfied that the declarant will subsequently accomplish all the formalities in respect of clearance they shall release the goods, provided that the declarant produces a commercial or official document giving the main particulars of the consignment concerned and acceptable to the Customs, and that security, where required, has been furnished to ensure collection of any applicable duties and taxes."[1]

The International Chamber of Commerce (ICC) in its Customs Guidelines[2], produced within the framework of the ICC Memorandum of Understanding with the World Customs Organization (WCO), further states that "a modern, efficient and effective customs administration:

- Establishes immediate release control systems, based on advance submission of prescribed data and post entry audit, that enable the importer or agent to obtain the goods prior to the completion of administrative requirements and payment of duties, taxes and fees, regardless of weight, size, type of operator or carrier or mode of transport." (Guideline 9); and
- "Operates a corporate surety bonding system, or other appropriate means, such as a duty- and tax-deferral system, to protect the revenue and ensure compliance with customs laws without unnecessarily delaying the release of goods." (Guideline 15)

The acceptance of customs bonds issued by insurance companies is widely considered to facilitate trade, and this would certainly be true in the case of Moldova. Once the range of acceptable trade securities in the local market is expanded, especially to include bonds issued by insurance companies, then Moldova will become a more attractive destination for trade.

According to the World Bank, every day of trade delay costs a country roughly one percent of total trade turnover.[3] In the 2014 World Bank Doing Business survey, Moldova ranked 150 of 189 economies in Trading Across Borders with 35 days to import and 32 days to export. Even a modest reduction in these times could lead to dramatic increases in GDP and increase Moldova's prospects for long-term growth and economic development. Increases in trade will also lead to further increases in trade revenues, which in 2012 totaled MDL 12.6 billion, or 67% of total budget revenues.

[1] The Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures, February 2006
[2] International Chamber of Commerce, Customs Guidelines, Paris, June 2012
[3] S. Djankov, et al., "Trading in Time," Review of Economics and Statistics, Nov. 2008, p. 1, available online at http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Methodology/Supporting-Papers/DB-Methodology-Trading-On-Time.pdf.

Customs Bonds Worldwide

A customs bond is a contract to ensure performance of a legal obligation. A customs bond is a surety bond whose beneficiary is the Customs department. Customs bonds are used worldwide to secure a variety of trade scenarios:

- To allow importers to take possession of goods, before the completion of customs formalities
- To regulate the transport of goods
- To enable a carrier to move goods that have not passed through from one customs place to another
- To regulate and license the activities of customs brokers
- To regulate temporary importation and similar suspensive regimes
- To regulate the activities of customs bonded warehouses
- To account for imported goods and payment of duties and taxes
- To regulate duty-free shops
- To regulate the return of commercial samples and display goods

There are typically two types of customs bonds:

- A *Continuous bond* is normally obtained by importers, who have a large number of entries or imports through multiple ports of entry during a given year. It is normally valid for one year, or until it is terminated by the surety or the principal.

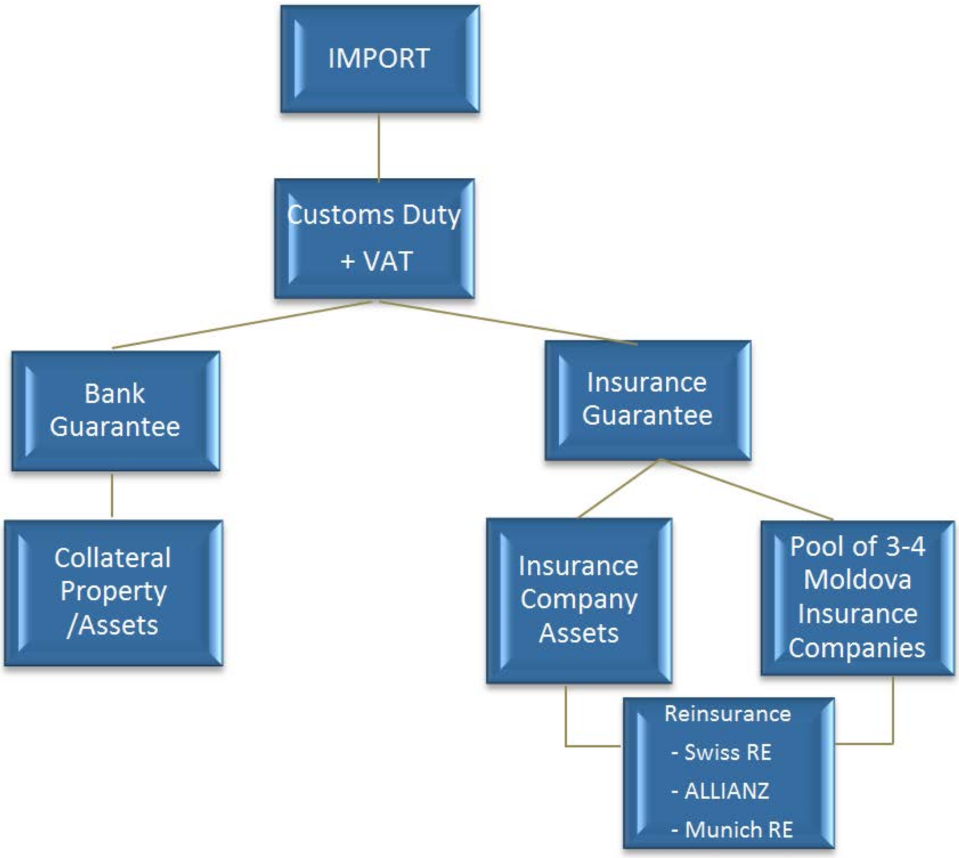
- A *Single-entry bond* is obtained by an importer for a single shipment, and accordingly covers only the entry or transaction for which it was written. The bond amount for a single entry bond is not less than the total taxes and fees owed to the customs department for the transaction.

As mentioned earlier, the WCO Revised Kyoto Convention (RKC) requires signatories within three years of singing to, among other things, legalize the use of surety instruments for a range of Customs formalities and, in particular, the immediate release of goods in advance of the completion of documentation requirements and the payment of any applicable duties and taxes. There are currently 91 signatories to the RKC (Moldova is not yet a signatory), of which over 70 have acceded to the convention prior to 2010. Therefore, the deferral of duties and taxes and the use of surety to secure payments and similar obligations are an international best practice and a fundamental feature of trade facilitation.

Bank Guarantees vs. Insurance Guarantees (Customs Bonds)

Presently in Moldova, for the purpose of guaranteeing customs payments, the legislation only recognizes bank guarantees. The use of these guarantees is further limited only to those required of all customs brokers as a condition for receiving a license, and is typically used to guarantee transit and other “suspensive regimes” (e.g. temporary storage/entry) of their existing clients. The minimum amount for this type of guarantee is 2 Million MDL, or approximately $154,000, and they are quite costly to obtain, as banks require collateral in the form of real property or other assets. This is because banks by nature are not risk takers. They appraise each applicant individually, evaluate his tangible assets, and then decide on the guarantee amount they are willing to issue on his behalf and at what cost.

Insurance companies in contrast are specifically designed to take on risk. Insurance companies can, subject to a proper **reinsurance agreement**, issue a guarantee without asking for tangible securities or assets from the same person or company. Insurance companies do not appraise guarantee seekers individually; rather they evaluate a whole pool of individuals or companies. Insurance companies normally base the price of their guarantees on a calculation of the probability of default of the pool. The diagram below illustrates the risk flow of both instruments.



Shifting this risk to the reinsurance market allows Moldovan insurance companies to write this class of business and offer lower cost guarantees to the trade community and Customs. Reinsurance companies already operate in Moldova and the possibility of a new class of business (customs bond) should spur local insurance companies to structure the guarantee in a way that satisfies the National Commission of Financial Markets.

The advantage of insurance guarantees over bank guarantees in the current context of Moldovan trade can be illustrated by the table below. Even without allowing for deferred payment of duties and taxes, customs bonds could be used as an alternative to secure the obligations of customs brokers as part of their licensing agreements, with significant savings in direct costs.

SECURITY FOR CUSTOMS BROKERS*		
Activity	**Bank Guarantee**	**Insurance Guarantee**
Appraisal of property	500 – 3500 MDL/object	-
Insurance of property	1%/year	-
Notarial fee	est. 12 500 MDL for 2 000 000 guarantee	-
State registration of lien	300 MDL / object	-
Bank examination fee	1% > 1000 MDL	-
Bank initiation fee	1000 MDL	-
Bank periodic/renewal fee	2 – 3% /year	-
Insurance Financial Guarantee	-	2% - 3%/year
Total	97 500 MDL	40 000 MDL

**Customs brokers are required by law to post a minimum guarantee of 2,000,000 MDL*

The savings to customs brokers are multiplied further by the working capital and assets that are freed up, since insurance bonds do not require collateral. This capital can then be redeployed to more productive uses in the Moldovan economy.

To illustrate this impact, Moldova Customs currently has over 328 million MDL ($25 million) in open bank guarantees for 65 licensed customs brokers. Because banks only accept about 60% of the overall property and asset value to cover the guarantee, this level of guarantee is backed by 548 million MDL ($42 million) in assets. Substituting an insurance bond for these guarantees could immediately release this amount of capital back into the Moldovan economy.

While insurance guarantees have certain advantages over bank guarantees in trade, there are benefits from having both bank guarantees and insurance guarantees available in the market, which can be summarized as follows.

- The competition between banks and insurance companies lowers the price charged for customs guarantees. The trade community can shop the market and pay competitive prices for the customs guarantees they need.
- The competition between banks and insurance companies forces each to provide efficient service to the trade community. The competitive rates for service charges and risk premiums charged by banks and insurance companies serve as mutual encouragement to cut down unnecessary procedures and provide efficient services.
- The trade community can save time and effort, and focus on its direct trade duties rather than on how to secure a customs bond. The competition between banks and insurers will bring the customs guarantee services to their door.
- Companies that have reserved capital can use it to secure customs guarantees from banks and pay minimal service charges. On the other hand, companies that cannot tie up their capital with banks can secure customs bonds from insurance companies.
- Companies of all sizes will have better opportunity to participate in international trade and compete in international markets. Low customs bond costs in turn lower production and trade transaction costs, which can make Moldova's companies more competitive in international markets.

Expanding the Market Further

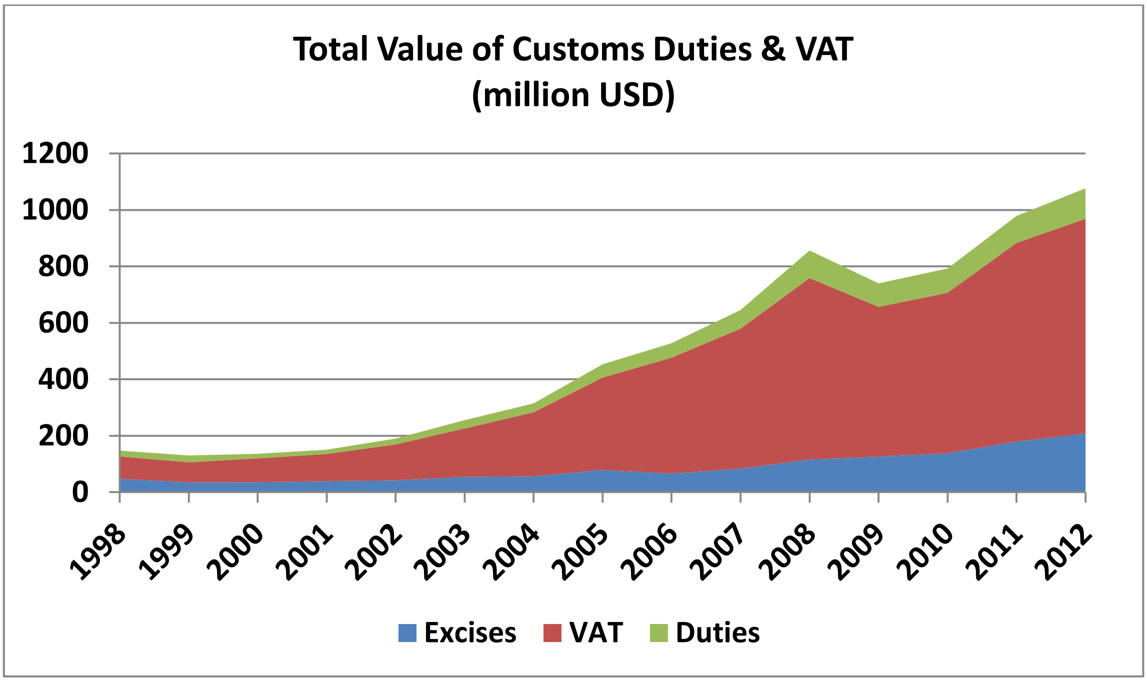
To estimate the potential size of the current market for customs bonds, we can start with the same value of current guarantees - 328 million MDL. Assuming a 2% bond rate[4] for the insurance backed guarantees, premiums could reach over $500,000 for this market alone.

But the market is not limited to only customs broker obligations. Insurance guarantees also could be applied to other trade scenarios that already take place in the market today, such as:

- Customs warehouse exposures
- Temporary admissions
- Items for enhancement and re-exportation
- Other "suspensive" regimes

If the payment of duties, taxes and other fees currently collected prior to the release of goods could be deferred until full customs clearance, the customs bond could easily secure these obligations as well. The minimum period for deferment required by the WCO is ten days, whereas in many developed countries longer periods, e.g. 30 days, are granted to Authorized Economic Operators (AEO).

For example, as of November 2013 there were 7,500 registered importers in Moldova. Assuming most regular importers would secure a continuous bond, a minimum premium of $1,000 for an annual bond[5] would generate $7,500,000 in premiums, though in the early stages the amount would be considerably less, perhaps closer to $2,000,000, since not all importers would avail themselves of the option and Customs would not likely accept them for all traders, preferring trusted traders initially. However, as the market matures there is the potential to cover more importers and transactions. The figure below illustrates the steady growth in trade revenues. Further trade facilitation will lead to increases in trade as well as trade revenue.



[4] This is a notional rate that tracks the rate of similar bonds in other markets, including developing countries.
[5] Assumes an annual bond valued at USD 50,000.

Customs Bonds in Moldova - Due Diligence and Findings

A review of existing legislation reveals that Moldovan law already recognizes insurance backed financial guarantees. Under Annex 1 to the Insurance Law, Category B, *General Insurance, Classes of general insurance permitted:*

- Item 14 - Insurance of Credits covering the following risks: insolvency; export credits; sales on credit; mortgage credit and agricultural credit.
- Item 15 - Insurance of Guarantees covers the following risks: direct guarantees and indirect guarantees.
- Item 16 - Insurance of Financial Losses, covering: unemployment risk; insufficiency of revenues; risks related to current expenses; unexpected commercial expenses; depreciation of market value; indirect commercial loss; non-commercial financial loss; and other financial losses according to clauses of the insurance contract.

The Moldova National Commission on Financial Markets publishes information on insurance companies and their premium and loss figures. The table below shows the size of the insurance market and that of insurance of financial risks, which is the category customs bonds fall within. It should be noted that the majority of the insurance companies in Moldova already write this class of business and the published loss ratio is quite profitable (see table below). Though it is presently a very small market, writing financial risk guarantees is clearly not a foreign concept to local insurance companies.

Insurance Companies' Results for Guarantee Business, 2012

Insurance Class	Gross Premiums Written (mil. Lei)	Reimbursements (mil. Lei)	Loss Ratio
Total (All Classes)	1089.27	430.51	39.5%
Credits	0.00	0.00	-
Guarantees	0.29	0	0%
Financial Losses	7.44	1.47	19.8%

Source: Moldova Commission on Financial Markets

The Moldovan insurance market is thinly capitalized; however it is operating at a profit, as it operates within its own limitations. There is an interest and willingness on the part of insurance companies to explore these types of sureties, and the market is capable of supporting a customs bond/financial guarantee program, and it will benefit greatly by the use of reinsurance and by the concept of "pooling", which uses a group of three to four companies to minimize the amount of risk per company.

It should also be noted that large limits will not be needed to support this program and these bonds/guarantees should fall easily into the comfortable net retention area for each of the companies that choose to participate. If underwritten correctly, with an initial focus of writing this business for low-risk economic operators, the loss ratio should track favorably with other worldwide markets and show a significant profit.

Underwriting and claims assistance will need to be provided to the insurance sector. This can be accomplished through technical assistance and specialized workshops for insurance companies, and the learning curve should be short.

In discussions with the Customs Service and local insurance companies, it appears the underwriting guidelines and the claims process would be similar to what exists today. Applicants for custom bonds would be required to submit information on their trade activities, commodity types, years in business, typical shipment values and revenue obligations, history of compliance with the Customs Service, and other details that might affect the underwriter's risk assessment. From an administrative standpoint, the Customs Service is prepared to handle any type of guarantee.

The claims process could also mirror that of bank guarantees. The current guarantee template and language included in Government Decision No. 1290 of December 9, 2005 (see Annex 1) can be applied easily to customs surety bonds. Furthermore, the Customs Service will enjoy the same time and notice and payment features that exist under the current bank guarantees, that is, if a default situation occurs, the principal has 4 days to respond and satisfy Customs. If the matter is not resolved in this period, Customs may notify the insurance company and request payment within 3 days. The insurance company may then seek reimbursement from the importer under the terms of the insurance agreement (indemnity agreement).

Furthermore, insurance Brokers can be quite useful in the distribution chain to importers once a deferred payment scheme is approved. There are 65 independent insurance brokers in Moldova and they control 25% of the business placed with insurance companies. The remaining 75% is placed by insurance company sales representatives. The insurance brokers understand the concept of surety business and financial guarantees, and they are eager to become agents for this new class of business.

Recommendations and Next Steps

Government Decision No. 765 of September 25, 2013, commonly referred to as the "Road Map" calls for the implementation of streamlined customs procedures based on those applied in the European Union (EU). The Ministry of Economy has put forth a package of legal amendments that introduce streamlined customs procedures according to EU practice, which includes deferral of customs duties and taxes and an amendment to recognize other forms of guarantee beyond bank guarantees, i.e. customs bonds issued by insurance companies. Both of these reforms, as described herein could significantly reduce the cost of trade; increase the level of trade and, hence, trade revenues; increase per capita income; improve Moldova's ranking in global indicators and its attractiveness for direct investment. Furthermore, these benefits would accrue to all stakeholders.

Stakeholder	Benefits of Deferred Payments and Expanded Guarantees
Ministry of Finance	• Secured revenues • Higher revenues through increased trade
Customs Service	• Secured revenues • Claims and payment terms similar to bank guarantees
Insurance Industry	• New class of business
Importers/Exporters	• Accelerated release of goods • Lower costs/improved competitiveness
Customs brokers	• Lower costs • Freed-up working capital

It should be noted that these proposed reforms do not require either the Ministry of Finance or the Customs Service to offer deferred payment privileges to all importers or accept insurance guarantees in all cases. What they do is create the possibility for these conditions and pave the way for their eventual implementation and expansion. Certain steps are required in the interim by all parties to fully implement simplified customs procedures.

<table>
<tr><th>Stakeholder</th><th>Future Actions</th></tr>
<tr><td>Ministry of Finance</td><td>Accept the deferred payment of duties and taxes
Allow use of insurance bonds as an alternative to bank guarantees for current customs obligations</td></tr>
<tr><td>Commission on Financial Markets</td><td>Determine whether customs bonds fall under the classification of insuring against “financial risks”, or if this requires clarification of the specific use of customs bonds</td></tr>
<tr><td>Insurance Industry</td><td>Conduct research into the potential market for an insurance guarantee to secure all manner of trade obligations
Develop risk profiles; pricing
Investigate reinsurance possibilities (international reinsurers)
Develop underwriting procedures
Develop a certificate and claims procedures acceptable to the Customs Service</td></tr>
<tr><td>Customs Service</td><td>Develop procedures for applying deferred payment of trade revenues, the terms of which could be tailored to different classes of economic operators and range from 0-30 days, e.g.
— Authorized Economic Operators
— High-volume trusted traders
— Low-volume trusted traders
— Less trusted traders (new entrants)
Work with insurance companies to develop acceptable certificate and claims procedures.</td></tr>
</table>

CONCLUSIONS

Allowing for deferred payments of duties and taxes as a trade facilitation measure is an EU and international practice that should be adopted in Moldova. If added to the package of simplified clearance procedures already proposed by the Ministry of Finance[6], this would allow for the immediate release of goods in most cases. Expanding the range of acceptable guarantees would provide adequate security to Customs and the MoF but at a potentially much lower cost to the trade community. In either case, the market will have to adjust to these changes and this will take time. These also could be implemented on a pilot basis and expanded later based on results.

USAID BRITE stands ready to assist the MoF, the Customs Service, and the insurance industry with capacity building and other technical assistance to help expand the market for guarantees and implement procedures for managing them and deferred revenue payments.

[6] Draft Law of the Republic of Moldova On Tax and Customs Policies 2014

Annex 1 – English translation

Annex no. 2
to Regulation on Customs Brokers
and Customs Clearance Specialists' Activity

Sample Bank Guarantee Letter

Bank Guarantee

no. _____ as of ____________

By this letter,

Banca Comercială, whose registered office is at: *xxx*, represented by the chairman Mr. *Xxxx Xxxx*, acting in accordance with its Charter, hereinafter referred to as **SURETY**, at the request of,

SRL "Broker", whose registered office is at: *xxx*, identification number *xxx*, represented by the chairman, Mr. *Xxxx Xxxx*, acting in accordance with its Charter, hereinafter referred to as **PRINCIPAL**,

issues this solidary guarantee to the Customs Service, hereinafter referred to as **BENEFICIARY**, under following conditions:

1. **SURETY** and the **PRINCIPAL** solidarily commit themselves to irrevocably pay the customs bond or penalties and fines charged to the **PRINCIPAL** up to the maximum amount of ________**lei** _______**bani**, at first written request sent by the **BENEFICIARY** to the **SURETY,** within 3 banking days of receipt of the request.

2. In the event of the SURETY default to meet the commitments made as to the due date for payment and the amount mentioned in item 1 to this guarantee, the **BENEFICIARY** may collect this amount, indisputably, directly from the account of the **SURETY**:

   - correspondent account;
   - bank account

3. This guaranty takes effect as of _______ and is valid before ___________.

4. This guaranty have effect from the date of entry into force and expires automatically after the date pointed out in item 3, if the written payment request of the BENEFICIARY, filled in accordingly, was submitted to the SURETY up to and including this date.

5. During the validity period stated out in item 3, this guarantee cannot be withdrawn by the **SURETY** without a written consent of the **BENEFICIARY**.

6. Under no circumstances the right to this guarantee shall be transferred to other persons.

UNDERWRITING

Bank Chairman

Annex 1 - Romanian

Anexa nr.2
la Regulamentul cu privire la
activitatea brokerului vamal şi a
specialistului în domeniul vămuirii

Modelul scrisorii de garanţie bancară

Garanţie bancară
nr. ______ din ____________

Prin prezenta,

Banca Comercială, cu adresa juridică: *xxx*, în persoana preşedintelui care activează în baza statutului băncii, denumit în continuare **GARANT**, la cererea,

SRL "Broker", cu adresa juridică: *xxx*, cod IDNO *xxx*, în persoana preşedintelui, dlui *Xxxx Xxxx*, care activează în baza statutului, denumit în continuare **ORDONATOR**,

eliberează prezenta garanţie solidară pentru a fi prezentată Serviciului Vamal, denumit în continuare **BENEFICIAR**, în următoarele condiţii:

1. GARANTUL se angajează solidar cu **ORDONATORUL**, la prima cerere scrisă de plată a **BENEFICIARULUI** şi remisă către **GARANT**, să efectueze, în mod irevocabil, în termen de 3 zile bancare din data primirii cererii, plata obligaţiei vamale sau a amenzilor şi penalităţilor apărute la **ORDONATOR** pentru orice sumă pînă la concurenţa sumei maxime de ________ **lei ____ bani.**

2. În cazul neonorării de către **GARANT** a angajamentelor asumate privind termenul de achitare şi suma plăţii nominalizate în pct.1 al prezentei garanţii **BENEFICIARUL** poate încasa această sumă, în mod incontestabil, direct din următorul cont al **GARANTULUI**:
– cont corespondent;
– cod bancar.

3. Prezenta garanţie intră în vigoare la data de ___ şi este valabilă pînă la data de _______.

4. Prezenta garanţie produce efecte din data intrării în vigoare şi expiră în mod automat după data indicată în pct.3, dacă cererea scrisă de plată a **BENEFICIARULUI,** completată în modul stabilit, a parvenit la **GARANT** pînă la această dată inclusiv.

5. În decursul perioadei de valabilitate indicate în pct.3, prezenta garanţie nu poate fi retrasă de către **GARANT** fără acordul scris al **BENEFICIARULUI**.

6. Dreptul asupra prezentei garanţii nu este transmisibil altor persoane în nici un mod.

Preşedintele Băncii