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UNLOCKING FINANCE FOR GROWTH

SECURED TRANSACTIONS REFORM IN PACIFIC ISLAND ECONOMIES

UNLOCKING FINANCE FOR GROWTH

SECURED TRANSACTIONS REFORM
IN PACIFIC ISLAND ECONOMIES

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ABBREVIATIONS

ADB	Asian Development Bank
IMF	International Monetary Fund
OECD	Organisation for Economic Co-operation and Development
PPSA	Personal Property Securities Act
SMEs	small and medium-sized enterprises
STA	Secured Transactions Act

I. INTRODUCTION

In many countries in the Pacific region, it is difficult to obtain credit. Many financial institutions believe that lending is extremely risky and that loans may not be repaid. There is, however, a means to reduce lending risk through legal and institutional changes. Commonly described as secured transactions reform or personal properties securities reform, these reforms can potentially transform access to credit for firms and individuals.

Reforming the secured transactions framework enables borrowers to more easily pledge “movable property” as security for loans.¹ Although the principles of pledging collateral as security are easily understood, an effective and very specific legal framework must exist for borrowers to readily provide movable assets as collateral for loans, and for lenders to speedily repossess and sell them after any default. Over time, an effective collateral framework reduces lending risk and promotes investment and entrepreneurship. Secured transactions reforms will improve financial intermediation and deepen financial markets.

Mobilizing finance is important. As much analytical work has documented, strong correlation exists between financial market development and growth.² Without access to finance, entrepreneurs cannot obtain funding to take advantage of opportunities, firms cannot finance investment, productivity improvements cannot be funded, and growth potential is wasted.

This document explains why secured transactions reform is necessary, the characteristics of a secured transactions framework, and some experience in Pacific countries that have adopted the reforms. Early sections discuss the potential of secured transactions frameworks for overcoming some constraints on access to credit, and explain some of the terms associated with collateralizing loans. The document then details some important aspects of the reforms in Pacific island economies, and the outcomes in Solomon Islands and Vanuatu to end-2013. The concluding section discusses further issues to be addressed to fully realize the potential of secured transactions reform, as experience to date demonstrates that a supporting legal framework is itself insufficient.

¹ Examples of movable property include machinery, tools, inventory, crops, accounts receivable, future earnings, land rents, royalties, vehicles, vessels, and airplanes.

² See P. Holden and V. Prokopenko. 2001. *Financial Development and Poverty Alleviation: Issues and Policy Implications for Developing and Transition Countries. IMF Working Paper 01/160*. Washington, DC: International Monetary Fund; and M. Ayyagari, A. Demirgic-Kunt, and V. Maksimovic. 2005. *How Important are Financing Constraints? The Role of Finance in the Business Environment*. Washington, DC: World Bank. The latter analyzes firm surveys to ensure the impact of the business environment on growth. They find that access to finance is one of the most important determinants of firms' growth rates, along with crime and political instability.

II. KEY FINDINGS AND RECOMMENDATIONS

The legal foundations for secured transactions reform exist in seven countries in the Pacific region. However, a more detailed examination of the experiences in Solomon Islands and Vanuatu shows that intensive implementation is still needed to increase the use and effectiveness of using secured transactions as a foundation for lending. Recommended actions include:

- **Further publicize the new framework's advantages** for businesses, many of which are unaware of its use. Chambers of commerce would be natural partners, although they will first require significant internal training.
 - **Work with lenders** to help them use the framework and develop new financial products, particularly by using accounts receivable. There is some evidence that mid-level officials in commercial banks and other lenders are still not using the new framework.
 - **Develop supply chain financing** in the agricultural and other sectors. Agricultural finance could be greatly increased if lenders, larger growers, wholesalers, and distributors are incorporated in a financing chain.
 - **Use government accounts receivable** to secure credit. A major untapped potential source of relatively low risk lending and financing is assisting firms supplying governments by providing loans secured by government accounts receivable.
 - **Reduce state-owned enterprises' drain** on government budgets by using their accounts receivable to secure bank financing.
-

III. INCREASING CREDIT THROUGH SECURED TRANSACTIONS REFORM

A number of factors have raised lending risks in the Pacific and made it difficult for Pacific businesses to obtain credit. Secured transactions reform addresses the constraints to lending through unlocking the collateral value of movable assets.

A. CONSTRAINTS ON ACCESS TO CREDIT

- **Problems using land as collateral.** To date, lenders have generally required land or land leases as security for loans. However, this has led to many problems arising from communal and traditional forms of land holdings. Seizure after default is especially difficult and can take years. As a result, the nonperforming loan ratio for lending secured by land is in the double digits in many countries in the region.
- **Uncertainty of legal interests.** In countries where it was possible to pledge limited forms of movable property, the systems of registrations were inadequate to assure lenders that borrowers' assets had not been pledged as security for another loan and that, if they registered a security interest in collateral, it had priority.
- **High legal costs.** The costs involved in obtaining pledges of assets were high and required lawyers to draw up loan documents tailored to a specific borrower with the assets being pledged as security. Since each transaction was a "one-off" event, legal fees and the associated procedures effectively excluded all but the largest borrowers.
- **Weak legal systems.** Many laws governing financial transactions were outdated.³ The inadequacy or nonexistence of bankruptcy legislation could negate lenders' rights to seize assets pledged as collateral if a borrower declared bankruptcy.
- **Poor enforcement mechanisms.** Failure to repay required lenders to obtain court authorization and use court officials to seize the pledged assets. Court systems are underfunded and enforcing judgments was difficult and sometimes impossible. In some countries, it could take months or years to execute a court award, during which time the assets could deteriorate or disappear altogether. Expedited procedures allowing rapid collection and disposal of secured assets were absent before reform.

- **Weak financial regulation and supervision.** Banks are undercapitalized in some Pacific island economies. Bank supervisory capacity is often not strong, although the Pacific region's foreign banks are supervised from the countries in which they are based.
- **Government-directed credit.** Development banks often lend to favored sectors of the economy—or politically connected borrowers—at artificially low interest rates. Development banks are unlikely to lend to highly productive sectors. Governments are frequently the biggest borrowers.
- **Lack of credit information.** There is very little credit information on potential borrowers. In many countries, bank privacy laws prevent information exchange. Credit bureaus can help the poor build credit histories, turning favorable credit reports into a substitute for collateral.

As a result of risks to lenders associated with providing loans secured by collateral, businesses had difficulty obtaining credit to finance both ongoing operations and expansion. Numerous interviews with businesses indicated their difficulty accessing credit. The average ratio of private sector credit to gross domestic product in most Pacific island economies was under 50%, compared with over 65% for low and middle income countries in other parts of the world.⁴ Effectively, financial systems were closed to all but the largest borrowers or those owning the limited amount of freehold real estate in the region. Promising start-up projects were not funded, agriculture sectors were starved for funds, and government contracts were available only to large firms that could finance lengthy delays in being paid. This pushed a significant portion of economic activity into informal sectors where productivity and investment is low, with a corresponding effect on incomes and poverty. In particular, it disadvantaged small and medium-sized enterprises (SMEs), because they were starved for credit.

Secured transactions reforms reduce the security aspect of risks to lenders, increase the number of eligible borrowers, and increase the range of borrowing instruments for accessing credit. These benefits can only be realized, however, if the legal framework enables the use of movable assets as collateral.

³ Some laws dated from the 19th century.

⁴ See World Bank Group. 2014. World Development Indicators. <http://databank.worldbank.org/data/views/variableSelection/selectvariables.aspx?source=world-development-indicators>

B. LEGAL FRAMEWORK AND COLLATERAL

Problems with the legal framework for lending largely explain borrowers' inability to obtain loans secured by movable property. Further, all borrowing is associated with high transactions costs in obtaining loans, higher interest rates because lending is risky, and difficulty of seizing pledged assets after a default. Many enterprises do not even bother to apply for loans when collateral requirements are so high.⁵ This limits access to finance and financial market development in most middle- and low-income countries. A secondary effect is a shortened credit chain. This means that, unlike in countries with highly developed financial markets, few businesses extend credit terms to their customers. Borrowing against inventories or warehouse receipts is rare, equipment purchase through leasing is unusual, and specialized financial institutions do not exist.

The result is underinvestment in capital equipment and smaller than optimal inventory holdings.⁶ This imposes high costs, especially in remote countries where resupply is difficult because of distances from suppliers. Businesses need to hold higher inventories than those in countries with nearby suppliers and shorter delivery times because they face the risk of running out of things to sell, or inputs to keep their businesses going. Since higher inventory requires financing, access to credit at reasonable cost is especially important to promote productivity and competitiveness in the Pacific region.

A specific legal framework must be in place to mobilize movable property as collateral. Alternatively known as a secured transactions act (STA) or a personal property securities act (PPSA), the law simplifies and ensures the legal processes that allow for the pledging of movable assets as security for loans and the conditions under which, after default, lenders may repossess the assets. Any type of asset except real estate can be readily used as collateral. Examples of these assets are machinery, tools, inventory, crops, accounts receivable, future earnings, land rents, royalties, vehicles, vessels, and airplanes.

This framework has many advantages because it reduces risks associated with securing loans with collateral. In particular, it provides more options for medium to smaller firms to obtain financing, with direct and positive flow-on effects for the

economy.⁷ Because these reforms reduce the risk of lending, they mobilize the assets of potential borrowers, promote the development of new financial products, and result in financial market development throughout the region.

Where a legal framework disallows personal property as collateral, the ability to borrow is limited, particularly for smaller businesses or those that cannot pledge real estate. Large companies with significant assets and strong borrowing power—based on cash flow projections and high credit ratings—may be able to obtain unsecured loans. This is generally not true for SMEs struggling to obtain access to finance and that cannot rely on land as collateral.

In well-developed financial systems, personal property can be used as collateral with relative ease. It is simple to pledge assets and easy to seize them after any default. This is how most lending occurs in countries like Canada, New Zealand, and the United States, where the ability to pledge collateral rests on a sound legal foundation. Since a substantial portion of enterprises' assets consists of movable property, a well-functioning secured transactions framework improves their ability to borrow. For example, United States data show that movable assets constitute about 60% of businesses' capital stock.⁸ Furthermore, disaggregating the composition of movable assets reveals that 39% constitutes plant and equipment, 30% constitutes intellectual property, 20% accounts receivable, 10% inventories, and about 1% automobiles. In a system where the secured transactions framework has been reformed, all of these have the potential to function as collateral for loans. In unreformed systems, such as those that existed in the Pacific region, most of these assets could not be used as collateral.

A World Bank survey in 60 low- and middle-income countries indicated that the composition of assets banks accepted as collateral comprised 73% land and buildings, 18% machinery, and 9% accounts receivable (Footnote 4). In countries with unreformed secured transactions (or PPSA) frameworks, there is a massive mismatch between actual enterprise assets and those that banks are prepared to accept as collateral. Furthermore, lenders require that the value of collateral as a percentage of the loan amount be high. In 2009, lenders to enterprises in Fiji required, on average, collateral equivalent to 215% of the loan amount.

⁵ World Bank Group. Enterprise Surveys: What Businesses Experience. <http://www.enterprisesurveys.org/Data/ExploreTopics/finance>

⁶ P. Holden. 2001. *Promoting Financial Market Development Through Secured Transactions Reform*. Washington, DC: Inter-American Development Bank.

⁷ Footnote 6; W. Warren and S. Walt. 2013. *Secured Transactions in Personal Property*. 9th ed. St. Paul, MI: Foundation Press.

⁸ See H. Fleisig, M. Safavian, and N. de la Pena. 2006. *Reforming Collateral Laws to Expand Access to Finance*. Washington, DC: World Bank.

Table 1: Loan-to-Value Ratios for Borrowers^a

Type of Collateral	Emerging Markets		
	OECD	Friendly/Reformed	Difficult/Unreformed
Immovable Property	Up to 90%	Up to 80%	Between 60%–80% (cities) 30%–60% (rural areas)
Movable Property			
Vehicles	Up to 100%	Between 70%–100%	Between 60%–85%
Equipment	Up to 80%	Up to 80%	Between 60%–80%; most times no value (secondary collateral)
Accounts Receivable	Up to 80%	Up to 50%	No value (secondary collateral)
Inventory	Up to 50%	No value (secondary collateral)	No value (secondary collateral)

OECD = Organisation for Economic Co-operation and Development.

^a The loan-to-value ratio is defined as loan/collateral value.

Source: Investment Climate Advisory Services. 2010. *Secured Transactions Systems and Collateral Registries*. Washington, DC: World Bank Group. <https://www.wbginvestmentclimate.org/uploads/SecuredTransactionsSystems.pdf>

Economic data suggests that countries that have modernized their secured transactions laws have experienced significant increases in credit access for the private sector, with a lower percentage of nonperforming loans and lower credit cost.⁹ This results in greater investment and growth.¹⁰ This evidence is supported by studies in Organisation for Economic Co-operation and Development (OECD) countries and in reforming countries that have “a higher degree of [legal] development [in] their credit systems by increasing the effective use of movable collateral to secure credit.”¹¹ The reformed legal frameworks for secured transactions translate to higher productivity and economic growth, particularly among SMEs.¹² Other studies confirm that countries that have implemented secured transactions reforms are

better able to support economic growth and employment.¹³ Further, borrowers can use a greater proportion of their assets’ value to secure loans, in essence leveraging their ability to borrow (Table 1).

Sometimes observers suggest that banks rely on “cash flow lending” and should not concern themselves with collateral. However, cash flow lending fails to address two particular problems associated with providing loan finance: moral hazard and asymmetric information. Moral hazard raises the lending risk because the borrower takes more risk with the lender’s money if the costs of not repaying a loan are low. Asymmetric information arises because borrowers always have more information about their businesses than lenders can ever have and therefore could conceal negative information when applying for or renewing loans.

However, if businesses or persons pledge their assets as collateral, which can be seized after a default, they have much more incentive to act prudently and to not conceal adverse information from lenders.

⁹ The key is effective reform and modernization. There have been instances of secured transactions reform in other countries around the world that have not led to increased lending, primarily because the reforms were incomplete, did not feature factors described in this document, or failed to repeal existing laws governing lending. For example, after New Zealand introduced its Personal Property Securities Act, there was a sharp rise in lending, with many new security interests being registered. In Eastern Europe, particularly Albania and Romania, the number of security interests registered rose substantially after the reform. See M. Safavian and S. Sharma. 2007. *When Do Creditor Rights Work? Policy Research Working Paper 4296*. Washington, DC: World Bank.

¹⁰ W. Warren and S. Walt. 2013. *Secured Transactions in Personal Property*. 9th ed. St. Paul, MI: Foundation Press.

¹¹ Investment Climate Advisory Services. 2010. *Secured Transactions Systems and Collateral Registries*. Washington, DC: World Bank Group. See also: International Finance Corporation. 2006. *Emerging Collateral Practices in Countries with Reformed and Unreformed Secured Transaction Frameworks*. Washington, DC: World Bank Group.

¹² A. Galindo and A. Micco. 2005. Bank Credit to Small and Medium-Sized Enterprises: The Role of Creditor Protection. *Inter-American Development Bank Latin American Research Network Working Paper No. 527*. Washington, DC: Inter-American Development Bank.

¹³ M. Safavian. 2008. Firm-level evidence on collateral and access to finance. In F. Dahan and J. Simpson (eds). *Secured Transactions Reform and Access to Credit*. Cheltenham, UK: Edward Elgar.

IV. THE KEY FEATURES OF A SECURED TRANSACTIONS FRAMEWORK

This section discusses some of the more technical aspects of secured transactions reforms, including the legal forms for creating security interests and the essential features of a well-functioning secured transactions framework.

For a secured transactions framework to function effectively, (i) the costs of creating security interests should be low, (ii) the rights and obligations of all parties to the transaction should be clear, (iii) the procedures related to pledging assets should be specific, and (iv) default procedures should occur rapidly with minimal recourse to the courts. Successful secured transactions reform requires each stage to be legally unambiguous and inexpensive.

A. DEFINITIONS

Common legal concepts associated with a secured transactions framework:

- **Security interest** is a conditional property right that secures an obligation, and is central to the pledge, mortgage, and other transactions secured by personal property. It is conditional because the right can only be exercised if the borrower defaults.
- A security interest **attaches** to collateral when it becomes enforceable against the debtor, the person who gives the security interest.
- A security interest is **perfected** when the secured lender (the person who takes the security interest) enforces it against third parties. These may be other creditors who take a security interest in the same property, people who obtain liens on the property, or people who buy the collateral from the debtor.
- Transitional filings relate to lenders' existing security interests under the previous unreformed system. Following the reform, lenders are given time to transition their security interests to the new system. This transitional period consists of simply recording the security interests on the new electronic registry. During the transitional period, lenders can file existing security interests at any time and have full priority. Therefore, two competing considerations exist in

setting the time period for transitional filings. The longer the period, the more likely that all existing security interests are recorded. However, during the transitional period, it is unlikely that new loans will be granted because lenders have no confidence that they have priority over pledged collateral.

B. CREATING SECURITY INTERESTS

The most common instruments used to create security interests:

- **Pledge.** A pledge is the delivery of an asset for security. The asset may be goods, documents of title, negotiable instruments, or other tangible property. The security interest attaches to the goods, and the security interest is perfected when the creditor takes possession of the asset.
- **Lien.** A lien is a right to hold property until an obligation is discharged. A lien may arise by agreement of the debtor, or by operation of law. Unlike the pledge, the property is not transferred for security. For example, if a television is delivered for repair, the repair shop may have a lien on it until payment is made. Unlike the pledge, there is no power to dispose of the property at common law, though a statute may provide such a power.
- **Mortgage.** A mortgage on personal property is a transfer of a property right to the creditor, entitling the creditor to foreclose on the right upon default and to take possession of the property with a right to convey title. Upon performance by the debtor, the mortgage right is discharged.
- **Charge.** A charge is a property right entitling a creditor to seize an asset upon a condition (e.g., failure to pay an obligation). A fixed charge attaches when an agreement has been made, the creditor gives value to the debtor, and the debtor acquires rights in the charged property, whichever occurs last. Under a fixed charge, the debtor may not dispose of the charged asset. Therefore, fixed charges enable equipment finance, but are not useful for inventory finance, because inventories are constantly changing. A floating charge may attach to a changing pool of assets, rather than one particular asset.

C. KEY FEATURES OF SECURED TRANSACTIONS FRAMEWORK

While lenders may deny the wish to repossess pledged collateral, the possibility that they can provides strong incentives for borrowers to adhere to loan contract terms and to strive to repay. The secured transactions law (or PPSA) must provide four essential elements needed to govern borrowers' abilities to pledge property at low cost, and for lenders to take collateral and repossess after a default:

(i) Create a Security Interest

The law must permit clear, low cost methods for creating a "security interest" on the part of the lender. In general, borrowers and lenders should be free to secure obligations with personal property without undue expense, legal restrictions, and burdens. A simple agreement should secure an obligation with nearly any form of personal property: tangible and intangible property, present, and future-acquired property. The parties may agree that the debtor will remain in possession of the collateral and may (or not) sell, deal in, or otherwise dispose of the collateral with (or without) the creditor's knowledge or consent. This is especially important when inventory is used as collateral. Typically, the debtor will need to sell the inventory and buy new stock—i.e., rotate stock during the life of the loan. The agreement needs to allow inventory to be sold and newly purchased goods that move into inventory to become collateral, without a new agreement.¹⁴

(ii) Prioritizing Security Interests

The law must set logical and clear priorities among different claims on pledged assets. This is known as establishing priority. The law must set rules for the time of security interests' registration, from which a right will prevail against other claimants to the same property. Secured transactions law clarifies these issues with priority rules that specify borrower, lender, and third party rights under different commercial situations. The rules should specify whose rights have priority, and under what circumstances.

"Secured" lending is less than secure when previous creditors already have, and future creditors could acquire, rights to the collateral. Collateral value diminishes when others may assert claims against it, including judgment holders who obtain writs of execution, tax authorities that can seize collateral based on a tax lien unknown to the lender, and bankruptcy trustees. Further, since the debtor may sell or otherwise dispose of collateral, there must be rules that determine acquired buyer and other transferee rights to the collateral.

(iii) Publicizing Security Interests

In making a loan, a lender must know if the assets in which the security interest is being created have been pledged as security for a loan from another lender. This is important because after a default, lenders must know who has the first right to the proceeds of a sale of assets. The law must provide for a practical, effective, and sustainable system to publicize rights, so that potential lenders can easily determine whether an asset is the subject of a security interest. A system that publicizes security interests is therefore needed that allows the creditor to file a notice specifying the parties to the loan agreement, and describes the pledged collateral. In well-functioning modern systems, easily available information should indicate that a security interest exists, via a searchable database. Filing does not need to be burdensome, nor be subject to state agency scrutiny. The notice in the database will show when the security interest was registered, thereby establishing a priority right for any dispute among creditors and other third parties.

The notice serves two purposes: (a) it warns prospective creditors and buyers of possible prior security interests in the debtor's property; and (b) the date of notice filing indicates the date by which competing claims to collateral are measured. The first filer has first priority after default. The description of collateral in the notice may be general, but must sufficiently explain the possible status of the debtor's property to prospective lenders and buyers. With modern technology, notice-filing offices are often operated electronically. This gives quick Internet access to information about filing security interests, and provides fast, efficient, and accurate services to borrowers and lenders. It also substantially reduces uncertainties surrounding conflicting claims.

(iv) Enforcement

The secured transactions law must set out a workable system for enforcing lenders' rights, including seizure and sale after default. The law's success depends upon creditors' abilities to speedily enforce their rights. Upon default, the creditor must have the right to take possession or control of the collateral, and sell or otherwise efficiently dispose of it. A sale may be through public or private facilities. Collateral may be disposed of in whole or part and the collateral may be leased or licensed. Regulating a creditor's efforts to obtain value from collateral must be sensitive to the collateral type and the commercial circumstances in which the creditor must act.

Often, it is unnecessary to go to court to seize and sell property upon loan default. Judicial intervention is not needed when a secured creditor disposes of collateral in the creditor's possession or control. Secured creditors often maintain possession of documents of title, warehouse receipts, and

¹⁴ This procedure, known as a "floating charge," applies to constantly changing assets—including debtors or accounts receivable.

negotiable instruments. Upon default—and without judicial permission—they have statutory authority to sell or lease the collateral, and statutory authority to collect on accounts receivable pledged as collateral. Judicial intervention may only be necessary for a noncooperative debtor in possession of tangible collateral, to repossess the property and give it to the creditor.

D. FINANCING THAT SECURED TRANSACTIONS REFORM ALLOWS

In countries where secured transactions reforms have taken place and been effectively implemented, a far broader range of ways exists to finance businesses. Some examples of the types of finance that well-functioning law permits: supply chain financing; the financing of seed and fertilizer secured by the proceeds of sale of future crops; cattle financing; the financing of inventories; financing against future receipts from a contract with the government or a large firm; and loans against future land lease payments or royalty payments. This framework provides substantial benefits to businesses, particularly SMEs.

E. COMMON MISCONCEPTIONS REGARDING SECURED TRANSACTIONS REFORM

In spite of its importance, misconceptions surround secured transactions that lead to unrealistic expectations regarding its effectiveness and confuse the functioning of the reforms. The most important include:

- **Unrealistic expectations.** It is a mistake to consider this reform a panacea for immediately improving access to finance. The reforms take time to be understood, and for lenders to gain confidence in the new framework. The reforms will not lead immediately to more credit, or to an upsurge in growth. It took New Zealand nearly a decade to fully implement secured transactions reform.
- **The need to register security interests.** Even some bankers do not understand that under a reformed system, security interests must be registered, including those that were secured under the previous unreformed system. Failure to register the interest will leave the holder only with an equitable interest, which will always rank behind any registered or legal interest.
- **Borrowers register assets.** A common misconception among those who do not fully understand the framework is that borrowers must register their assets to qualify for loans. However, it is lenders who register a security interest in the assets of borrowers. There is no mechanism for borrowers to register their assets.

F. ISSUES IN EVALUATING THE LEGAL FRAMEWORK FOR SECURED TRANSACTIONS REFORMS

Although evidence from other countries points to the clear benefits of secured transactions reform, rigorous evaluation of developments in the Pacific region is clearly desirable (Footnote 7). In doing so, the question of what constitutes a successful reform arises. There are potential outcomes that would signal success, including:

- The legal reform complies with all the elements of a well-functioning secured transactions framework. It covers the creation, registration, and promotion of security interests, and their enforcement after any default.
- The system for searching registrations of security interests is efficient and low-cost.

G. INDICATORS TO EVALUATE THE IMPACT OF SECURED TRANSACTIONS REFORMS

- Interest spreads between loans secured by real estate and those secured by movable property should fall, because the value of movable property as collateral will increase with the reform. Lenders should then perceive that loans secured by movable property are less risky.
- Per capita filings of security interests is an alternative measure that the European Bank for Reconstruction and Development uses to measure secured transactions reform in Eastern Europe.
- The value of loans secured by movable property further indicates the reform's success. Yet, unless there is a specific design built into the registry, it is difficult to determine the value of loans secured by movable property. Registries contain information on the borrower's name, the date of registration of the security interest, and a description of the assets securing the loan. There are no loan value data, as this is sensitive information. Registry information is publicly available, and borrowers want neither competitors nor curiosity seekers to know how much they are borrowing. However, bank regulators (usually central banks) do have an interest in ready access to lenders' value of secured loans relative to unsecured loans. An electronic solution to providing this information—keeping the information hidden from general view—would be a worthwhile evolution of the electronic registries and would allow evaluation of this indicator.

- Surveys of firm financing in the Pacific region would provide valuable information on the success of reforms, and also give insight into firms' capital structure, working capital, fixed investment financing, percentage of loan value required by lenders as collateral, interest rates paid, and movable assets as a percentage of firms' total assets. While these data are unavailable pre-reform in the countries where secured transactions reforms

have taken place, tracking such indicators over time would give valuable information on firm financing in the Pacific region.

- Specific indicators to develop include the actual costs of creating security interests; costs of enforcing collateral subject to repossession; and interest rate risk components.

V. SECURED TRANSACTIONS REFORMS IN THE PACIFIC

The Pacific region has seen a wide-ranging program of secured transactions reform in Pacific island economies and the two large modern economies, Australia and New Zealand. This section outlines the outcomes in the region and discusses reforms in Solomon Islands and Vanuatu. The latter offers preliminary descriptions of developments to date, information on loans recorded, problems in implementation, and what is needed to advance the reforms.

A. OVERVIEW OF PACIFIC REGIONAL REFORMS

New Zealand was the first in the Pacific to introduce a modern secured transactions framework, implementing the PPSA in 2002. The Federated States of Micronesia followed in 2006. To mid-2014, there have been six more fully implemented reforms in Pacific economies. Papua New Guinea and Samoa have also passed PPSAs and now await the installation of the online registries. Australia began implementing its STA in 2012. Together, this represents one of the most extensive programs of regional reform in the world (Table 2).

The underlying rationale for secured transactions reform implemented in Pacific countries is to provide more stakeholders with access to credit by mobilizing personal property as collateral. All the reforms completed so far contain the essential provisions for a well-functioning secured transactions framework. The legal foundation is sound and the electronic registries, which are easily searchable, ensure that there are no prior pledges against property being offered as collateral.

One aim of secured transactions reform in Pacific island economies has been to implement regimes that simultaneously reflect the same underlying general legal principles and allow for greater international harmonization, while incorporating local variants that reflect specific individual country requirements in the region. Since all of the legal forms are similar, one main PPSA goal is to promote increased investor and creditor confidence from the legal uniformity across Pacific jurisdictions.

Table 2: Secured Transactions Reform in the Pacific^a

Jurisdiction	Relevant Act	Filing Office (and Websites)
New Zealand	Personal Property Securities Act 1999	Personal Property Securities Register http://www.ppsr.govt.nz/cms
Federated States of Micronesia	Secured Transactions Act 2006	Secured Transactions Filing Office http://securedtransactions.dea.fm/Public/AboutFilingOffice.aspx
Marshall Islands	Secured Transactions Act 2007	Republic of the Marshall Islands Secured Transactions Filing Office https://stformi.com/
Vanuatu	Personal Property Securities Act 2008	Personal Property Securities Registry https://ppsr.vu/
Solomon Islands	Secured Transactions Act 2008	Secured Transactions Filing Office https://stfosi.com/
Australia	Personal Property Securities Act 2009	Personal Property Securities Register http://www.ppsr.gov.au/Pages/ppsr.aspx
Tonga	Personal Property Security Act 2010	Personal Property Securities Registry https://ppsa.to/
Papua New Guinea	Personal Property Security Act 2011	Registry will be installed in 2014.
Palau	Secured Transactions Act 2012	Palau Secured Transactions Filing Office https://www.stforop.com/index.aspx
Samoa	Personal Property Securities Act 2013	Registry will be installed in 2014.

^a In chronological order, from earliest to most recent.

Source: Pacific Private Sector Development Initiative.

B. STATISTICS ON REFORM RESULTS

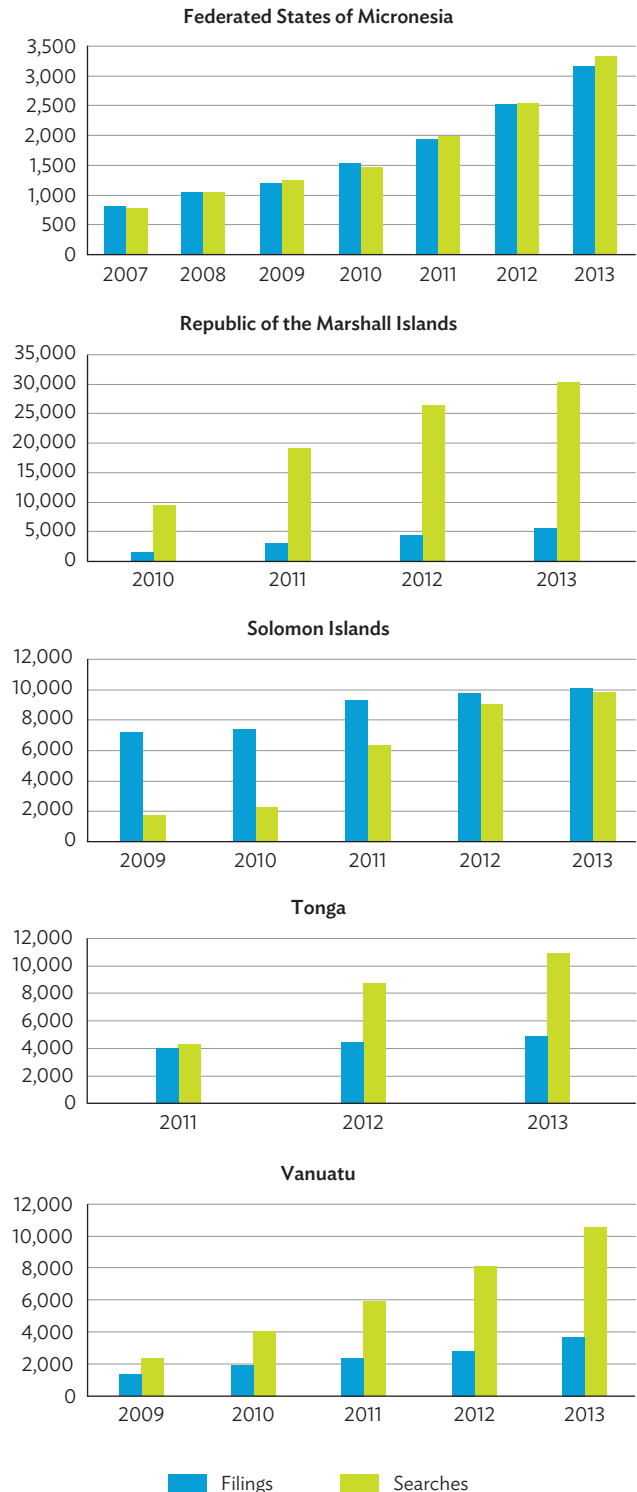
The figure shows security interests and searches in five Pacific island economies where secured transactions reforms have been completed. Secured loans and searches are shown cumulatively, indicating the number of filings made since the reform was implemented. The secured transactions reforms resulted in over 27,000 outstanding secured loans in the region by the end of December 2013.¹⁵

The registries are being actively searched. There have been over 65,000 searches to mid-2014; remarkable given the region’s population size. An approximate ratio between the number of loan applications and loans granted is reached by subtracting searches from loans, giving the number of searches not resulting in a loan. For every 2.5 searches, there is one secured loan. However, a single loan application might have more than one search so, in reality, this ratio is likely smaller.

Benefits to smaller businesses are measurable. Although data on company size do not exist, registration of security interests sampled shows that the majority of company registrations have been by smaller companies. Further, the secured transactions framework provides an upward path of credit expansion to small companies as they grow. This is critically important for enhancing productivity and growth more generally, since the greatest benefits to economies is less from establishing small businesses and more from successful businesses expanding.¹⁶

These are promising results. Yet, the full potential of the reforms is far from realized. A preliminary review of their effectiveness through private sector assessments and country visits has revealed that some bankers are unaware of how to use the new framework, most businesses are unaware of the potential for borrowing, bank regulators do not realize its potential for strengthening bank regulation, and much work remains to ensure increased access to finance. The following section highlights these issues in more detail through the case studies of Solomon Islands and Vanuatu.

Figure: Cumulative Searches and Security Interests Registered in Five Pacific Countries, 2007–2013



Sources: Secured transactions registries in the Republic of the Marshall Islands, Federated States of Micronesia, Solomon Islands, Tonga, and Vanuatu.

¹⁵ The number of secured loans is calculated by adding new security interests registered or modified and subtracting terminations of security interests, which occur when loans are paid off. Obtain cumulative data by adding the total number of security interests recorded each year and subtracting those that are discharged.

¹⁶ J. Haltiwanger, R.S. Jarmin, and J. Miranda. 2013. Who Creates Jobs? Small versus Large versus Young. *The Review of Economics and Statistics*. 95(2). pp. 347–361. The MIT Press: Cambridge, MA.

VI. REFORM IN SOLOMON ISLANDS AND VANUATU

This section describes the progress and issues encountered in a review of secured transactions reforms in Solomon Islands and Vanuatu to end-2013. With a view to regular updating, it was undertaken to: (i) determine how the new frameworks are being used, and (ii) to identify further implementation issues.

A. PRE-REFORM—SECURED LENDING IN SOLOMON ISLANDS AND VANUATU

This section briefly describes the system that the reform replaced, to explain the nature and extent of secured lending reform in Solomon Islands and Vanuatu. In both countries, traditional legal support for secured lending had roots in legal forms established by either statute or common law, derived from English law.

In Solomon Islands and Vanuatu, considerable uncertainties existed (and still do) around land ownership and title issues. Still, many lenders considered (and still do) mortgage law strong enough to support secured lending. Pre-reform, many of the issues identified in this study existed in both countries. Secured lending was organized around various costly legal forms, some subject to registration and others not. Registries were cumbersome and offered limited, often unreliable, information. Other problems included:

- (i) The secured lender's priority against third parties was not established by registration, but rather by legal formality and technicality that failed to consider all potential competing claims.
- (ii) Individual and group borrowing ability are limited, unless they own formal registered companies. Since reforms of the Companies Acts had not occurred and it was costly to register a formal company, incentives for becoming formal were weak. As a result, much economic activity occurred in the informal sector.
- (iii) The system was costly for borrowers because they had to pay substantial legal fees associated with loan documents, each of which was unique and had to be drawn up by a lawyer.
- (iv) Stamp duty was often payable on the value of the loan, which constituted a tax on borrowing that reduced the demand for credit.
- (v) Enforcement was expensive and uncertain.

Before the reforms, the most commonly used lending instruments were:

- **The company charge (fixed and floating).** This instrument was created upon registration of a security interest at the company registry.
- **The registered bill of sale.** This was the main instrument available to individuals to borrow under a secured lending framework. Individuals could give fixed charges under the Bills of Sale statutes.¹⁷ Floating charges were impossible under that legal form, or any other legal form available to an individual borrower.
- **Other functional equivalents of security.** Creative lawyers used a range of other devices because of defects in the fixed charge and the registered bill of sale. Title retention devices avoided the fixed charge and registered bill of sale's formality, technicality, and cost. Under a title retention scheme, the lender held title to the goods—sometimes posing as a lessor. Payment of the purchase price triggered the title transfer from title-retaining seller/creditor to buyer/borrower. Upon default, the “owner” of the goods reclaimed them. Forms of title retention used were the conditional sale, the hire-purchase agreement, and the finance lease.

Lawyers needed to physically search the various paper-based registries to determine if an asset had been pledged to another lender. This was both costly and uncertain, because documents were frequently misplaced or lost.

B. REFORM FEATURES

In 2008, Solomon Islands and Vanuatu enacted secured transactions reform¹⁸ and electronic registries commenced operation under both Acts in 2009. Vanuatu's PPSA and Solomon Islands' STA are similar, with a few notable differences. The reforms established priority rules governing competing claims to collateral by responding to commercial needs, rather than legal formality and technicalities. They also used simple enforcement rules, and processes became significantly less costly.

¹⁷ The Bills of Sale Regulation in Vanuatu appears in Chapter 23 of the consolidated legislation. The Bills of Sale Act in Solomon Islands appears in Chapter 174 of the 1996 edition of consolidated legislation. The source of the regulation and the Acts dated from the second half of the 19th century.

¹⁸ Vanuatu's Personal Property Security Act No. 17 of 2008 was adopted on 6 June 2008, and commenced on 7 July 2008. The registry was established on 23 April 2009. The Solomon Islands Secured Transactions Act 2008 was adopted on 7 August 2008, and commenced upon registry establishment on 24 August 2009.

Both reformed traditional secured lending law by establishing simplified notice filing registries, which operate electronically and without government registrar intervention. These registries need only:

- (i) the secured party's name and address (i.e., the person or institution providing the loan or the credit);
- (ii) the debtor's name and address (i.e., the borrower); and
- (iii) a collateral description (e.g., general or specific) including asset serial numbers where required—for example, when a security interest in a motor vehicle is recorded.

C. POST-REFORM—CREATING SECURITY INTERESTS IN SOLOMON ISLANDS AND VANUATU

Under the reformed laws, a security interest attaches to collateral by the same simple rules,¹⁹ no matter the form of transaction.²⁰ In a single agreement, any borrower (individual or corporate) may give any lender a security interest in any personal property, whether owned at the time or acquired after the time of the security agreement. No special form or terminology is required. Collateral may be personal property that becomes fixed by attachment to, or installation on, real property. Collateral may be minerals or timber, or other real property that is severable to become personal property. A debtor need not be a corporation to give a floating charge in collateral although, in Solomon Islands, an individual cannot give a floating charge in consumer goods.²¹

Collateral may be described either generally or specifically. General collateral classifications are permitted, such as equipment, inventory, accounts, crops, livestock, and documents of title, negotiable instruments, or consumer goods. Rather than an exhaustive list of registrable charges—as in the old Companies Act and the Bills of Sale Act—the new laws apply to all transactions that create security, no matter the terminology. The laws also apply to transactions not traditionally considered as creating security, such as title retention and consignment. The law applies whether the owner of the collateral is the debtor or the secured lender.²² For notice (registration) and priority, even leasing is subject to the new law.²³

¹⁹ A security interest attaches by (i) agreement of the parties; (ii) when the debtor has rights in collateral; and (iii) when secured party gives value to the debtor, whichever occurs last. See Vanuatu PPSA, Section 26 and Solomon Islands STA, Section 8.

²⁰ The parties may call the agreement a pledge, charge, hire purchase, financial lease, or use any other terminology. The effect is the same in each case. An agreement by which the debtor grants a security interest in collateral to the secured party has the same effect. See Vanuatu PPSA, Section 3 and Solomon Islands STA, Section 3(1)(a).

²¹ Solomon Islands STA, Section 6.

²² See Vanuatu PPSA, Section 10; Solomon Islands STA, Section 3(1)(a).

²³ See Vanuatu PPSA, Section 3; Solomon Islands STA, Section 3.

Registration is not required for some types of collateral (e.g., goods, documents of title, and negotiable instruments) if the secured lender takes possession of the collateral. Possession by the secured lender is considered a means of perfection, like registration.²⁴ If a secured lender takes and maintains possession of collateral, a later secured party who registers a notice will have a junior interest to the secured lender who has taken and maintained possession.

Stamp duty does not apply to transactions subject to the PPSA in Vanuatu, but remains effective in Solomon Islands. However, stamp duty payment is not a prerequisite to register a security interest.

D. REGISTERING SECURITY INTERESTS IN SOLOMON ISLANDS AND VANUATU

The new secured transactions laws of Solomon Islands and Vanuatu are innovative in form and substance. Registration and public searches of registry records are only available via Internet search. There are no fees for searches and the registry can be searched using the debtor's name, the registration filing number, or asset serial numbers—including motor vehicle identification numbers.

Registrations are paperless, online, and occur instantaneously, eliminating uncertainty about the exact time and date of recording security interests. Documents submitted for registration are not examined, and no certificates are issued that can be used as evidence of the existence or validity of a security interest. The registry requires very little input from personnel, which greatly reduces cost.

Unlike traditional unreformed paper registries, the new registries operate on “notice filing” principles. Registration serves only two purposes:

- providing notice to the public to inquire further before buying or taking a security interest in property of the same nature described in the notice;²⁵ and
- establishing a priority date (the registration date) by which competing claims to collateral may be settled.

By limiting the purposes of registration, the processes are simplified. A notice only need identify the borrower and lender,

²⁴ See Vanuatu PPSA, Section 43; Solomon Islands STA, Section 13(b).

²⁵ In early 2014, a lender in Vanuatu repossessed a vehicle in which it had a security interest even though the original owner (and borrower) had sold it to a third party. Under the law, purchasers have the obligation to check that whatever they are buying has not been pledged as security for a loan. This is easily done at no cost by searching the electronic registry.

and describe the collateral. A broader range of instruments can then be used to secure loans, including title retention, consignments, leasing, factoring, and the sale of accounts.

Registration is permitted before the parties sign a security agreement. This benefits complicated transactions with a large pool of collateral, because the prospective lender may file a notice before due diligence and finalizing negotiations with the debtor. When a loan agreement is executed, a security interest and priority in the collateral will already have been established under the first-to-file rule. Further, a notice is sufficient to perfect security interests in multiple security agreements. This provides flexibility to accommodate the financing needs of rapidly growing businesses, which could require multiple financing agreements. By permitting advance registration, it is unnecessary for the lender to return to the registry to file a notice each time a new agreement is made regarding the same collateral.²⁶

The new system is inexpensive. In both countries, registration-filing fees of security interests are approximately \$30 compared with several hundred dollars before the reforms.

E. SEARCHES AND SECURITY INTERESTS RECORDED

The registration pattern in the first year showed many filings in the transition periods (April–July 2009 in Vanuatu, and September–November 2009 in Solomon Islands). One large bank decided to register all its personal loans secured by pensions, resulting in many registrations of notice of prior security interests. This practice has ceased in Solomon Islands and Vanuatu, due to the added registration costs for the borrower and because organizations such as the Solomon Islands National Provident Fund maintain their own database of pledges. Most financial institutions now discourage using pension accounts as security, due to potential loss of an important asset upon default.

The data indicate that both registries are actively used to search prior security interests. Although unclear who, exactly, is searching as the registries are publicly accessed, the data affirms discussions with financial institutions undertaking searches as regular practice. Vanuatu has a more consistent number of searches, while Solomon Islands displays greater search variability consistent with the large variation in registrations figures.

F. GEOGRAPHIC DISTRIBUTION OF REGISTERED SECURITY INTERESTS

The notice registrations data indicate that the majority of credit transactions involve borrowers in the main province—Shefa Province in Vanuatu (including Port Vila) and Capital Territory in Solomon Islands (including Honiara). Solomon Islands has a wider credit transaction geographic distribution, due to more developed centers of economic activity beyond Honiara (Tables 3 and 4). The proportions have remained consistent over 2009–2013.

Table 3: Geographic Distribution of Security Interests, Solomon Islands

	Year				
	2009	2010	2011	2012	2013
Main Province	63.0	90.9	48.8	56.5	61.1
Other Provinces	37.0	9.1	51.2	43.5	38.9

Source: Solomon Islands Secured Transactions Filing Office, <http://www.stfosi.com>

Table 4: Geographic Distribution of Security Interests, Vanuatu

	Year				
	2009	2010	2011	2012	2013
Main Province	84.1	87.1	83.1	88.6	87.2
Other Provinces	15.9	12.9	16.9	11.4	12.8

Source: Vanuatu Personal Property Securities Registry, <http://www.ppsr.vu>

However, expanding mobile banking, greater awareness, financial institution acceptance, and greater rural investment means the trends may change. At least one financial institution in both countries intends to expand loan services in rural areas using nonconventional joint ventures.

G. THE GENDER OF BORROWERS

Both countries' registry software was upgraded to collect information on borrowers' genders in July 2010 in Vanuatu and August 2010 in Solomon Islands. Since many security interests were registered before these dates in both countries, many have not recorded borrowers' genders.

²⁶ See Vanuatu PPSA, Section 122; and Solomon Islands STA, Section 30(3).

Table 5: Gender of Borrowers with Secured Loans^a

Country	Equally Men and Women	Majority Women	Majority Men	Indefinable
Solomon Islands	51	567	1,656	7,457
Vanuatu	166	222	919	1,719

^a At June 2013.

Sources: Solomon Islands Secured Transactions Filing Office; Vanuatu Personal Property Securities Registry.

Nevertheless, women are actively using the secured transactions framework either as equal parties or as majority members of a borrower group (Table 5). Although women have registered fewer security interests than have men, the simplified registry process and the certainty introduced by the new framework are clearly encouraging women to take out loans.²⁷

The ability to pledge movable property is helping women to meet financial institutions' collateral requirements—effectively, allowing them to borrow—as they are rarely able to pledge land or leases as loan security. The secured transactions reforms have created additional opportunities for women to participate in business, although interviews during the evaluation mission revealed that women borrow lesser amounts than men.

Further issues in promoting women's borrowing revealed by lenders and women's business groups were: (i) many women lack basic business skills; and (ii) those with business experience remain reluctant to approach lenders. Encouragingly, some financial institutions are beginning to address these issues through targeted initiatives.²⁸

H. COLLATERAL USED TO SECURE LOANS

A broad range of assets is being used as collateral in both countries, most commonly motor vehicles. This is likely because lenders are not yet fully acquainted with the range of assets available under the new framework. Most businesses use a common asset to secure loans: a general security interest in the businesses' assets, both current and future. Other forms of collateral are being pledged in both countries, including household items, boats and other vessels, airplanes, cattle, inventory, gold, and financial securities such as shares (Table 6).

²⁷ Because gender disaggregated data were unavailable during the transitional filing periods and the first year of operation, it is not possible to ascertain if more women are borrowing compared with the old system. Anecdotal evidence suggests that more borrow now.

²⁸ One example is the corporate social responsibility programs of banks like Westpac, which runs a women's business program. Through targeted training, the women participants establish a relationship with the financial institution and obtain loans.

Table 6: Assets Used to Secure Loans^a

Assets	Solomon Islands	Vanuatu
Motor Vehicles	544	1,827
General Charge over a Company's Assets	271	382
Equipment	36	56
Financial Securities	8	32
Boats	8	25
Household Goods		24
Airplanes	2	5
Inventory		1
Bank Deposits	108	
Pensions	8,475	

^a At October 2013.

Sources: Solomon Islands Secured Transactions Filing Office; Vanuatu Personal Property Securities Registry.

However, unfamiliarity with the new system is evident because inventory and accounts receivables are not being heavily utilized.

In Solomon Islands, many charges have been registered over pensions for personal loans. However, as a matter of policy, financial institutions are reducing this form of secured lending.

I. POST-DEFAULT ASSET SEIZURE

Interviews with lenders²⁹ indicated that repossession has not been a major issue in Solomon Islands or Vanuatu. Financial institutions are confident in their rights and ability to seize movable property after a default. There have been few cases where it has been difficult to execute repossession, and financial institutions report that they have rarely had to request assistance from the sheriff.

Although there were no court tests by the end of 2013 in either jurisdiction, most stakeholders do not anticipate any issues given the legislation's thoroughness and the strong legal precedents in jurisdictions such as New Zealand. Lenders identified the main problem as the rate of asset depreciation (especially on motor vehicles), which are often in poor condition when repossessed. This would not be a problem if lenders used accounts receivable financing.

²⁹ Interviews were conducted during field visits in October and November 2013.

J. LENDERS' PERCEPTIONS OF THE REFORMS

In Solomon Islands and Vanuatu, there was consensus from financial institutions, lawyers, and central bank staff that (i) the reforms had greatly strengthened the financial system, and (ii) the law and registries are functioning effectively. Procedurally, the registries have operated effectively to enable financial institutions to ensure their priority as the secured creditor. There were few issues regarding their priority rights to assets for repossession.

Financial institutions in both countries also indicated substantial efficiency gains in reduced labour costs and legal fees. Staff of these institutions compared the new framework's easy use, with the replaced system's problems. For example, pre-reform, there had been several cases where company charges had taken 2 years to record, and significant uncertainty regarding priority had remained after this. Except for one major bank in Solomon Islands and another in Vanuatu, all financial institutions were familiar with the system and enthusiastically affirmed the ease and convenience for searches and registrations.

The review showed that nonbank financial institutions are using the new framework more intensively than the commercial banks. In Solomon Islands, one second-tier lender indicated that lending had increased by a factor of six at end-2013, as a direct result of the reforms. Similarly, in Vanuatu, a large wholesaler is making significant use of the secured transactions framework. Second-tier financial institutions indicated that their nonperforming loan (NPL) ratios were less than 2% at end-2013.

Ironically, banks rely on lending secured by fixed property, which they say is extremely challenging to manage after a default, and on which NPL ratios exceed 20%. By contrast, the NPLs secured by movable property—around 8%–15% of all bank loans—total less than 4%. For finance companies and wholesalers, which secure their loans exclusively with movable property under the new secured transactions frameworks, the NPL ratio is less than 2%.

K. BARRIERS TO COMMERCIAL BANK LENDING

Financial institutions are primarily concerned with borrowers' risk profiles. Legally enforceable security has less priority compared to borrowers' reputations, their business activities, and income receipts or salary. Banks in Solomon Islands and Vanuatu perceive that there are few "bankable projects". However, analysis revealed numerous instances where established businesses failed to qualify for credit, despite apparently sound collateral. For example, contractors dealing

with government in Solomon Islands engage in transactions over \$150 million annually. Contractors and government officials confirmed that payments are often delayed, but instances of nonpayment are rare. However, banks have not lent using these accounts receivable as security.

Further, chambers of commerce in both countries stated that banks continue to demand a very high ratio of collateral to loan value, often exceeding twice the loan amount. According to a women's business association in Solomon Islands, women are disproportionately affected as they have little collateral to begin with.

Another obstacle to increased secured transactions framework use is risk-averse banking policy from leading financial institutions' head offices. Lending policies are mainly directed towards fixed-property loans, and local branches have not received comprehensive guidelines on using the secured transactions framework. Knowledge of how to use the framework is limited—in both countries, some banks were not using the reformed system or claiming that they were still securing loans under the previous system. They did not realize that the bank then only had an equitable interest in the assets, and would lose priority if another lender registered a security interest in them.

The secured transactions framework is not yet fully integrated in banking policy for commercial banks' Pacific island branches. This may be partly explained by head-office experience and understanding of secured transactions. For instance, Australia has only recently reformed its secured transactions framework (the national personal property securities register took effect in January 2012) and bank head offices are addressing the issues associated with its introduction.

Several financial institutions have also indicated other important concerns with secured transactions besides efficiency, simplicity, and powers of foreclosure:

These include:

- reputational and public liability consequences when a large bank repossesses business assets of small businesses, trades people, or bus drivers;
- rapid asset deterioration in value (e.g., motor vehicles), increasing the risk of losing money on defaulting loans;
- practical challenges of repossessing in outer islands, with staff based in the capital cities; and
- defaulting borrowers easily selling or moving their assets and consuming the proceeds, before the financial institution can repossess.

SUMMARY AND THE WAY FORWARD

Additional data to track the impact of the reforms are being collected through the Pacific Private Sector Development Initiative, which has been instrumental in most secured transactions reforms in the Pacific region. The information on registration of security interests and searches illustrated in the figure is now being collected in real time through a secured transactions dashboard. Further data to track the impact of the reforms are also being developed. These include:

- information on the risk component of interest rates for loans secured by different types of property;
- per capita filings of security interests;
- the value of loans secured by movable property;
- the costs of creating security interests and how they change through time; and
- costs of enforcing collateral subject to repossession.

Currently, the use of the secured transactions framework in Solomon Islands and Vanuatu is usually associated with the bank's local branch manager and senior staff's knowledge and experience. Without substantially more implementation and awareness-raising, the new framework will continue to be underused and lending policy in both countries will remain cautious and conservative.

For usage to evolve—most importantly—banks need to use more accounts receivable as security for lending, including exploring further opportunities arising from government contractors of all sizes, who often have to wait extended periods to be paid. Accounts receivable financing removes concerns regarding reputational risk, asset deterioration, repossession, and the disappearance of assets that the banks cited as barriers to using the secured transactions framework.

Additionally, if banks are prepared to lend using accounts receivable as security, it will greatly expand the ability of retailers, trade and equipment dealers, and wholesalers to sell goods on credit, thereby lengthening the credit chain. This form of financing considerably increases opportunities for local consumers to buy products and commercial goods that they otherwise could not. Also, trade and equipment creditors are better able to repossess, store, and resell assets, with access to a readily available retail market and local customer knowledge. Unlike commercial banks, they understand their core business and have better knowledge of potential customers.

Several examples of new types of lending are also beginning to appear. In Solomon Islands, Credit Corp continues to expand its lending. Wilco, a building wholesaler, is increasingly using the secured transactions framework in Vanuatu. These alternatives would lead to greater use of the very substantial liquidity that exists in the financial systems of Pacific island economies. They will deepen the reforms and further open access to credit. Given the positive reception of the reforms and the familiarity that will occur over time, the framework will be used more intensively. Nevertheless, other systemic problems remain, particularly the lack of credit information, which significantly impedes a more widespread use of the system. Secured transactions reform and positive credit information complement financial market development.³⁰

In conclusion, the secured transactions reforms in the Pacific islands since 2006 are some of the most extensive reforms anywhere in the world. So far, with relatively limited implementation, lending has expanded significantly. However, much remains to be done before the full potential for financial market development is realized. Lenders need instruction on developing the far larger range of instruments now available to finance business activities. For full realization, donors and financial regulators will also need to actively support the full implementation of these new frameworks through extensive advocacy and engagement with commercial and noncommercial finance providers, the private sector, and community interest groups, including women's business organizations.

³⁰ Positive credit information includes data on payment history, the number of credit accounts outstanding, utility bills, etc. Negative information only includes poor payment history. In 2014, there are currently no credit bureaus in the Pacific that record positive information.

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Unlocking Finance for Growth

Secured Transactions Reform in Pacific Island Economies

The Pacific region has undergone one of the most extensive secured transactions reforms anywhere in the world. Although the reforms are relatively recent, initial results indicate that they will allow more borrowing—on better terms—than under the previous systems.

This publication was produced by the Pacific Private Sector Development Initiative, a regional technical assistance facility cofinanced by the Asian Development Bank, the Government of Australia, and the New Zealand Government.

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