

ASIAN DEVELOPMENT BANK

TAR:IND 34427

TECHNICAL ASSISTANCE

TO

INDIA

FOR

SECURED TRANSACTIONS REFORM

May 2002

CURRENCY EQUIVALENTS

(as of 2 May 2002)

| | | |
|---------------|---|------------------------|
| Currency Unit | — | Indian rupee/s (Re/Rs) |
| \$1.00 | = | Rs48.8800 |
| Re1.00 | = | \$0.0205 |

ABBREVIATIONS

| | | |
|-----|---|------------------------|
| ADB | — | Asian Development Bank |
| MOF | — | Ministry of Finance |
| TA | — | technical assistance |

NOTE

In this report, "\$" refers to US dollars.

I. INTRODUCTION

1. An effective secured transactions¹ regime has a fundamental role to play in a financial system. It can ensure enhanced access to credit by various sectors of the economy that have previously been excluded or have had only limited access to credit by expanding the pool of assets that can be used as collateral. A secured transactions regime can also contribute to stronger monitoring of corporate governance by creditors, improved transparency in determining the creditworthiness of debtors, and increased certainty in determining claimants to collateral, all of which promote access to credit and allow credit to be extended on better terms. Furthermore, a secured transactions regime can facilitate diversification of credit risk and financial intermediation by encouraging nonfinancial creditors like merchants, dealers, traders, and manufacturers and a more competitive credit market.² A modern secured transactions regime also supports reduction of transaction costs and improved access to credit by fostering efficient out-of-court creditor-initiated enforcement.

2. Building on long-standing interest in secured transactions law reform in India as reflected in the Rajamannar Committee Report of 1977, Indian policymakers participated in the Joint Symposium on Secured Transactions and Insolvency Law Reform hosted by the Asian Development Bank (ADB) in Manila in October 1999. During the Country Programming Mission for India in 2000, the Ministry of Finance of the Government of India (MOF) requested ADB technical assistance (TA) for developing a computerized registry system for movable property in India based on a suitable legal framework for secured transactions.

3. Constructive dialogue between ADB and MOF took place in 2000 and in 2001 on the parameters of ADB TA for a registration system for secured transactions. MOF's budget speech of February 2002 included reference to introduction of a bill for strengthening creditors' rights and security enforcement by banks and financial institutions. ADB has received formal confirmation from the Government on the purpose, output, methodology, key activities, cost estimates, and implementation arrangements for this TA to assist in the establishment of a suitable legal framework for secured transactions and a subsequent computerized registration system. The TA framework is provided in Appendix 1.

II. ISSUES

4. A modern legal framework for secured transactions will support the comprehensive taking of security interests irrespective of legal form.³ This will, for example, permit individuals, partnerships, and other entities that are not companies to obtain effective access to credit based on security interests in movable property. This is important to rural and urban small and medium sized enterprises, microfinance institutions, and "new economy" start-ups, all of which can make a potentially key contribution to economic growth and poverty reduction in India.

¹ A secured transaction is any transaction, regardless of its form, that is intended to create a security interest in personal property or fixtures, including goods, documents, and other intangibles. A security interest is a right given to one party in the asset of another party to secure payment or performance of an obligation. Collateral constitutes the assets over which security is granted.

² ADB. 2000. *Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral, Law and Policy Reform at the ADB, Volume II, Preface*. Manila.

³ The Rajamannar Committee report described the various inadequacies of the current Indian legal regime governing secured transactions.

5. A modern secured transactions legal regime in India will promote comprehensive registration of all security interests irrespective of their legal form.⁴ An effective legal regime for the creation, perfection, and enforcement of security interests, including the publicizing of all security interests in movable property, will enhance access to credit by debtors. This is due to the fact that comprehensive registration eliminates the uncertainty for third party creditors seeking to review the creditworthiness of a debtor against a backdrop of prior security interests in a particular legal form that did not have to be publicly registered. In addition, comprehensive registration of all security interests will lead to a transparent framework for publicizing them, thereby reducing dilatory and corruption-prone transactions that avoid whatever requirements apply.

6. Due consideration by a revised secured transactions law for self-help enforcement of security interests, with appropriate procedural safeguards for debtors, will make movable property an attractive source of collateral for credit by providing for enforcement of security interests without necessarily taking recourse to the courts in an already overburdened judicial system.

7. Based on such a modern legal platform, India can develop a computerized registration system, based on a first-to-file system, that is accessible by the public and supported by proper regulations and operating procedures. By giving potential creditors who turn to registries for information about other possible claimants to the collateral the confidence that they can protect their own security interests and obtain reliable data on prior security interests, such a registry system can reduce transaction costs for secured credit and significantly increase the speed of secured transactions. Without such an effective registry system, no law on security interests, no matter how modern, can deliver on the potential economic benefits of nonpossessory secured credit.

8. Finally a modern secured transactions regime will be an important complementary reform to India's plan to establish asset management companies for nonperforming loans of banks and financial institutions.

III. THE TECHNICAL ASSISTANCE

A. Purpose and Output

9. The TA will aim to improve the legal framework for secured transactions by providing (i) input and assistance to MOF on all aspects of legal reform options for secured transactions; (ii) assistance on evaluation of and consensus building for a modern legal framework for secured transactions and a modern registry system; and (iii) harmonization of a modern secured transactions regime with laws on social protection of debtors, including consumer protection laws.

⁴ Conventional forms of security interest include (i) security interests strictly understood (e.g., different pledges, which are property in the possession of the creditor; company charges; hypothecations; and mortgages, which are property in the possession of the debtor), (ii) hybrid security interests (e.g., conditional sales with retention or reversion of title), and (iii) security interests created under contract law (e.g., assignment of rights to accounts receivable to secure a loan).

10. The TA will also support the architecture for establishment of a computerized registration system that is comprehensive; self-sustaining; reliable; and easily, cheaply, and quickly accessible by the public through assistance on (i) overall design of the registration system, and (ii) capacity building and training in the establishment and operation of the registration system.

B. Methodology and Key Activities

11. To accomplish its objectives, the TA will have two phases:

Phase I : Reform of the Legal and Regulatory Framework

12. MOF, with the assistance of consultants engaged under the TA, will provide the principles of a modern secured transactions regime, the nature of amendments to current laws on secured transactions in India required for such a modern secured transactions regime, harmonization of laws on social protection of debtors under a secured transactions regime, and case studies under current Indian secured transactions laws. These will be discussed at a series of consensus-building workshops that will consider the opinion of relevant stakeholders, including government agencies, bankers, lawyers, representatives from the private sector, and the public sector.

13. ADB, in consultation with MOF, will select a modern registration system and accompanying legal framework for in-depth study together with two or three other registration systems for comparison. MOF, in consultation with ADB, will select up to three key persons from the Government or public sector to attend the study of registration systems. In addition, the members of the study tour will include private sector representatives on a self-financed basis.

14. Following the study of registration systems, MOF, in consultation with ADB, will evaluate at a workshop the kind of legal and regulatory framework needed to support a modern registry system.

15. MOF, with input from consultants provided under the TA, will undertake reform of the legal framework for secured transactions necessary to support a modern, computerized, registration system, taking account of (i) experience from other jurisdictions that have undertaken such reforms; (ii) legal design input drawn from relevant ADB regional technical assistance reports, relevant Indian legal reports, and input from the consensus-building workshops and campaign and from the evaluation workshop referred to in paras. 12-14 of this paper. All such inputs will be distilled by the consultants into the form of a legal design input report, which will include the draft secured transactions law recommended for India.

16. For the TA to continue to Phase II, ADB will determine, in consultation with MOF, that reforms to the legal framework sufficient to support a comprehensive, transparent, and effective registration system have been enacted — measured against the legal design input report.

Phase II : Architecture for Establishment of a Registry System

17. The consultants will prepare the overall design of a modern registration system based on the reformed legal framework for secured transactions including identification of equipment, software, staffing, links to existing registries, fee structure, public/private sector model assessments, training, and public awareness needed to support the introduction of such a registration system.

18. To build capacity to enable the necessary software for a modern registration system to be developed, the consultants will provide workshops on a simulated registration system based on the overall design (para. 17), to be held in selected cities such as Bangalore and Hyderabad.

19. In consultation with MOF, the consultants will design and carry out a comprehensive training and public awareness program of workshops and seminars that encompasses both the reformed secured transactions law and the principles of a modern registration system based on the overall design developed in accordance with para. 17. Trainees will be selected by MOF in consultation with ADB and the consultants.

20. A final tripartite meeting will be held to review the report and the recommendations of the consultants based on the capacity-building workshops and the training and public awareness workshops and seminars, and to assess the TA. Based on the conclusions reached at the meeting, the consultants will refine and finalize the overall design and the final report.

C. Cost and Financing

21. The total cost of the TA is estimated at \$625,000 equivalent, of which the foreign exchange cost is estimated at \$310,000 and the local currency cost at \$315,000 equivalent. ADB will finance the full foreign exchange cost plus \$190,000 equivalent of the local expenditures, for a total of \$500,000 — split between \$250,000 for Phase I and \$250,000 for Phase II. The TA will be financed by ADB on a grant basis from the ADB-funded TA Special Fund. The balance of the costs over and above ADB financing, mainly for counterpart support and secretarial services, office accommodation, office equipment and supplies, communications, and such documents and data as are required by the consultants, will be provided by the Government. Cost estimates are given in Appendix 2.

D. Implementation Arrangements

22. The Executing Agency will be the Banking Division of MOF. MOF will designate an appropriate official as project director, who will be responsible for managing the day-to-day activities of the TA and for coordinating with other agencies and concerned parties through a committee of stakeholders. The TA will be implemented over a period of 3 years and will be administered by ADB's Office of the General Counsel.

23. The TA will require the services of about 14 person-months of international consultant time and about 20 person-months of domestic consultant time with expertise in secured transactions law and design, and implementation and operation of computerized registration systems for secured transactions. The consultants in Phase I will be a team of individual international and domestic consultants selected on an individual basis in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for the engagement of domestic consultants. The consultants in Phase II will be a team of international and domestic consultants who will be engaged through an international consulting firm, using a simplified technical proposal, in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to the ADB for the engagement of domestic consultants. The consultants in Phase I and Phase II will operate as one larger team. The terms of reference for the consultants in Phase I and in Phase II are contained in Appendix 3. Equipment required under the TA will be procured by the international consultants in accordance with ADB's *Guidelines for Procurement*.

IV. THE PRESIDENT'S DECISION

24. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$500,000 on a grant basis to the Government of India for Secured Transactions Reform, and hereby reports this action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

| Design Summary | Performance Indicators/Targets | Monitoring Mechanisms | Assumptions and Risks |
|---|--|---|---|
| Goal <ul style="list-style-type: none"> • Reform of secured transactions law • Architecture for modern registry system | <ul style="list-style-type: none"> • Enactment of modern secured transactions law | <ul style="list-style-type: none"> • Tripartite reviews at end of Phase I and Phase II, interim reports of consultants and evaluation of participants after workshops and stakeholder response | |
| Purpose <ul style="list-style-type: none"> • To improve access to and terms of credit, transparency, diversification of credit risk, new credit providers | <ul style="list-style-type: none"> • Improved and varied access to credit | <ul style="list-style-type: none"> • Tripartite reviews at end of Phase I and Phase II; evaluation, consensus-building, capacity-building and training workshops; and reports of consultants after workshops and stakeholder response | <ul style="list-style-type: none"> • Laws not developed in accordance with principles of modern secured transactions regime, or not passed • Architecture for Registry not developed in a user-effective fashion • Insufficient understanding of new legal regime/vested interests |
| Outputs <ul style="list-style-type: none"> • Reform of legal and regulatory framework and architecture for new registry system for security interest on movable property | <ul style="list-style-type: none"> • Reports for workshops concluded by 2004, contributing to modern secured transactions law | <ul style="list-style-type: none"> • Agenda materials and reports prepared for workshops, legal design input report, overall design report, video, website, interim reports of consultants reviewed after workshops and tripartite reviews | <ul style="list-style-type: none"> • Laws not developed in accordance with principles of modern secured transactions regime, or not passed • Architecture for Registry not developed in a user effective fashion |
| Activities <ul style="list-style-type: none"> • Registration system study tour, evaluation workshop, consensus-building workshop(s), tripartite reviews, simulated registration system and capacity-building workshops, and training and public awareness program | <ul style="list-style-type: none"> • Completion of study tour, workshops, and training program | <ul style="list-style-type: none"> • Tripartite reviews at end of Phase I and Phase II and review of interim reports of consultants after workshops | <ul style="list-style-type: none"> • Laws not developed in accordance with principles of modern secured transactions regime, or not passed • Architecture for Registry not developed in a user effective fashion |
| Inputs <ul style="list-style-type: none"> • Consultants (14 person-months of international consultants and 20 person-months of domestic consultants) - Phase I \$140,000 | \$285,000 | <ul style="list-style-type: none"> • Tripartite reviews at end of Phase 1 and Phase 2 and review of interim reports of consultants after workshops | |

| | | | |
|---|------------------|--|--|
| - Phase II \$145,000 | | | |
| • Resource Persons | \$30,000 | | |
| - Phase I \$20,000 | | | |
| - Phase II \$10,000 | | | |
| • MOF/Government Working Groups, travel, workshops, equipment, others | \$132,000 | | |
| - Phase I \$67,000 | | | |
| - Phase II \$65,000 | | | |
| *Contingencies | \$53,000 | | |
| - Phase I \$23,000 | | | |
| - Phase II \$30,000 | | | |
| • Counterpart support | \$125,000 | | |
| - Phase I \$62,500 | | | |
| - Phase II \$62,500 | | | |
| Total TA Cost | \$625,000 | | |

MOF = Ministry of Finance, TA = technical assistance.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

| Item | Foreign Exchange | Local Currency | Total Cost |
|--|---------------------|-------------------|---------------|
| I. PHASE I | | | |
| A. Asian Development Bank Financing | | | |
| 1. International Consultants | | | |
| a. Remuneration | 80.0 | | 80.0 |
| b. Per Diem and Travel | 15.0 | | 15.0 |
| 2. Resource Persons | | | |
| a. Honoraria | 10.0 | 5.0 | 15.0 |
| b. Per Diem and Travel | 5.0 | | 5.0 |
| 3. Domestic Consultants | | | |
| a. Remuneration | | 40.0 | 40.0 |
| b. Per Diem and Travel | | 5.0 | 5.0 |
| 4. MOF/Government Working Groups | | | |
| - Per Diem and Travel | | 5.0 | 5.0 |
| 5. Registration System | | | |
| - Study Tour and Workshops | 40.0 | 5.0 | 45.0 |
| 6. Reports and Agenda Materials | 2.0 | 1.0 | 3.0 |
| 7. Videoconferencing, Video, Website | 5.0 | 9.0 | 14.0 |
| 8. Contingencies | 23.0 | | 23.0 |
| Subtotal (A) | 180.0 | 70.0 | 250.0 |
| B. Government Financing | | | |
| Office Accommodation, Local Communications, Office Equipment and Supplies, Counterpart Services, Secretarial Services | | 62.5 | 62.5 |
| Subtotal (Phase I) | 180.0 | 132.5 | 312.5 |
| II. PHASE II | | | |
| A. Asian Development Bank Financing | | | |
| 1. International Consultants | | | |
| a. Remuneration | 60.0 | | 60.0 |
| b. Per Diem and Travel | 20.0 | | 20.0 |
| 2. Resource Persons | | | |
| a. Honoraria | 5.0 | | 5.0 |
| b. Per Diem and Travel | 5.0 | | 5.0 |
| 3. Domestic Consultants | | | |
| a. Remuneration | | 50.0 | 50.0 |
| b. Per Diem and Travel | | 15.0 | 15.0 |
| 4. Equipment | | 25.0 | 25.0 |
| 5. MOF/Government Working Groups | | | |
| - Per Diem and Travel | | 5.0 | 5.0 |
| 6. Workshops | | 20.0 | 20.0 |
| 7. Reports and Agenda Materials | | 5.0 | 5.0 |
| 8. Videoconferencing | 5.0 | | 5.0 |

| Item | Foreign Exchange | Local Currency | Total Cost |
|---|-------------------------|-----------------------|-------------------|
| 9. Contract Negotiations | 5.0 | | 5.0 |
| 10. Contingencies | 30.0 | | 30.0 |
| Subtotal (A) | 130.0 | 120.0 | 250.0 |
| B. Government Financing | | | |
| Office Accommodation, Local Communications, Office Equipment and Supplies, Counterpart Services, Secretarial Services | | 62.5 | 62.5 |
| Subtotal (Phase II) | 130.0 | 182.5 | 312.5 |
| Total | 310.0 | 315.0 | 625.0 |

MOF = Ministry of Finance.

TERMS OF REFERENCE FOR CONSULTING SERVICES

A. Phase I (8 person-months international; 10 person-months domestic)

1. International Consultants (2 persons)

1. The international consultants will have the following responsibilities:

- (i) Organize expert resource persons, in consultation with the Asian Development Bank (ADB), who will participate as needed in workshops and seminars and in connection with the consensus-building campaign.
- (ii) Assist the Ministry of Finance (MOF) in consensus-building within India by (a) providing principles of a modern secured transactions regime, the type of amendments to current Indian laws governing secured transactions required for such a modern regime, harmonizing a secured transactions regime with laws on social protection of debtors, including consumer protection laws and case studies of issues arising under current Indian laws on secured transactions at consensus-building workshops; (b) assisting MOF in organizing the consensus-building workshops, which will include participants representing public and private interest groups; (c) developing a documentary video on secured transactions for dissemination and developing and operationalizing a website for an Internet-based consensus-building campaign on secured transactions; and (d) acting as resource persons at the consensus-building workshop, assisting MOF in preparing the workshop agenda and materials and preparing a report and recommendations at the end of the consensus-building workshops and campaign.
- (iii) Advise ADB and MOF on an appropriate registry system and an accompanying legal framework for secured transactions in preparation for an in-depth study program by selected government representatives, as well as two or three other registries for comparison.
- (iv) Assist the Phase II consultants in organizing the study program on registries.
- (v) Assist MOF in organizing an evaluation workshop after the conclusion of the study program on registries, to be attended by government and ADB representatives, and prepare a legal and regulatory options report for the workshop evaluating the type of legal and regulatory framework needed to accompany a modern registry system. The consultants will act as resource persons at the workshop, assisting MOF in preparing the workshop agenda and materials, and will prepare a report and recommendations at the end of the evaluation workshop.
- (vi) Provide a timely legal design input report appropriately tailored for India to MOF including a draft law on secured transactions, taking into account experience from other law jurisdictions that have undertaken such reform; relevant ADB, MOF, and Indian reports; the consensus-building and evaluation workshops; and the consensus-building campaign.

- (vii) Assist MOF during Phase II in ensuring that overall design for the computerized registration system is consistent with the new secured transactions legal framework.

2. Domestic Consultants (2 persons)

2. The domestic consultants will have the following responsibilities:
 - (i) Assist the international consultants in identifying appropriate domestic experts who can contribute to and participate in the workshops and seminars in connection with the consensus-building campaign.
 - (ii) Assist the international consultants in organizing MOF consensus-building within India, including (a) assembling material on and analyzing Indian legislation relevant to amendments of current Indian laws governing secured transactions; (b) making contact with potential participants from the public and private sectors in India for the consensus-building workshop; (c) assisting in the development of a documentary video and a website; and (d) acting as resource persons on agenda preparation for and preparing a report pursuant to the workshop.
 - (iii) Assist the international consultants in organizing of an MOF evaluation workshop after the conclusion of the study program on registries, including acting as resource persons on agenda preparation for and preparing a report pursuant to the workshop.
 - (iv) Assist the international consultants in preparing a legal design input report, including ensuring reference to all relevant Indian reports.
 - (v) Assist the international consultants in Phase II to ensure consistency with Phase I.

3. Tripartite Meeting

3. The consultants will present their findings to MOF and ADB in New Delhi on the enacted reforms of Indian law on secured transactions and the options for a modern registry system, taking account of views expressed at the workshops. For the technical assistance (TA) to continue to Phase II, a determination will be made by ADB, in consultation with MOF, as to whether the revised laws are sufficient to support a modern, computerized register that will effectively facilitate secured transactions.

B. Phase II (6 person-months international, 10 person-months domestic)

1. International Consultants

4. The lead consultant will do the following:
 - (i) Coordinate all administrative arrangements for the workshops in Phase I and Phase II.
 - (ii) Organize and arrange all aspects of the study program of registries. The study program should concentrate on the technical features and operation of the

registries, how the technical features and modern secured transactions laws and regulations are linked, administration of the registry, and how the integrity of the registry is safeguarded.

- (iii) Coordinate all equipment, software, staffing, training and public awareness needed for an overall designs report for a modern computerized registration system for secured transactions based on the reformed secured transactions laws that have been enacted.
- (iv) Coordinate simulated registration system workshops in selected Indian cities.
- (v) In consultation with MOF, design and carry out a comprehensive training and public awareness program of workshops and seminars that encompass both the revised secured transactions laws and the principles of an accompanying registration system for secured transactions. The training program will include train-the-trainers sessions for domestic resource persons and training material defining all the key legal, economic, financial, and technical terms connected with secured transactions (the defined terms). Training will target all relevant government officials, other providers of credit, the legal profession, and both private and public sector representatives. Trainees selected will be expected to have a working knowledge of the defined terms prior to the training sessions.

5. The technical consultant will do the following:

- (i) Prepare an overall design report for a modern computerized registration system under the overall coordination of the lead consultant. The overall designs report will include identifying equipment, software, staffing, training, and public awareness needed to support the introduction of such a registration system; preparation of links to existing registries (such as the motor vehicles registry); operation during a transition regime; preparing a fee structure that is both reasonable and capable of ensuring a self-sustaining operation; estimating office space and budget requirements and other institutional aspects; preparing bidding documents that meet ADB's guidelines; giving advice and assistance in canvassing and assessing possible private or joint private/public sector participation in the setting up, funding, and operation of the registry system; and advising on, and where necessary preparing, other elements required to establish and operate a workable, efficient, computerized registration system for secured transactions.
- (ii) Under the direction of the lead consultant, build capacity through simulated registration system workshops at selected Indian cities to enable the necessary software for a modern registration system to be developed. This capacity building will include the consultants moving a demonstration team from a registration system evaluated through the evaluation workshop in Phase I of the TA with a personal computer-based version of their system, a systems expert, and a management representative. The systems experts will explain the technical demands for operating the system to Indian systems experts. The management representative will provide information to Indian officials about overall operational characteristics, including safeguards for the integrity of the registration system, links to existing registries, and operation during a transition regime.

- (iii) Provide technical input to the Phase II lead consultant for all workshops in Phase I and Phase II and for the study program of registries in Phase I.

2. Domestic Consultants

6. The primary domestic consultant will assist the Phase II international consultants in all coordination and domestic administrative arrangements for the workshops and seminars in Phases I and II.
7. The technical domestic consultant will do the following:
 - (i) Assist the Phase II international consultants in an overall designs report, including advising on operations of existing registries, fee structures, estimation of institutional requirements, and assessment of possible private/public participation options for a registry system.
 - (ii) Assist the international consultants in the identification of appropriate Indian cities for simulated registration system workshops and for capacity building as part of the demonstration team.
 - (iii) Contribute to the training and public awareness campaign as trainers in the train-the-trainers program.
 - (iv) Provide technical input to the Phase II international consultants for all workshops in Phase I and Phase II.

3. Final Tripartite Meeting

8. A final tripartite meeting among MOF, ADB, and the consultants will be held to review the overall designs report and recommendations of the consultants, and an evaluation of the simulated registration system workshops and training program by participants, and to assess the TA. Based on the conclusions reached at the meeting the consultants will, within 45 days of the tripartite meeting, refine and finalize the overall design, including equipment, software, staffing, training, and public awareness needs, and estimated costs, in the form of a final report.