

ASIAN DEVELOPMENT BANK

TAR: STU37658

**TECHNICAL ASSISTANCE**  
(Financed by the Japan Special Fund)

**FOR**

**DIAGNOSTIC STUDIES FOR SECURED TRANSACTIONS REFORMS  
IN THE PACIFIC REGION**

December 2004

## ABBREVIATIONS

ADB	–	Asian Development Bank
PDMC	–	Pacific developing member country
PSA	–	private sector assessment
PSD	–	private sector development
TA	–	technical assistance

## TA CLASSIFICATION

<b>Targeting Classification</b>	–	General Intervention
<b>Sector</b>	–	Finance
<b>Subsector</b>	–	Finance sector development
<b>Themes</b>	–	Sustainable economic growth, private sector development
<b>Subthemes</b>	–	Developing rural areas, private sector investment

## NOTE

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

This report was prepared by A. Bruun, Pacific Department.

## I. INTRODUCTION

1. The Pacific islands recognize the importance of promoting economic growth by fostering an economic, political, and legal environment that is conducive to domestic and foreign investment, particularly the role of commercial laws and sound dispute resolution processes in facilitating investment and growth of the private sector.<sup>1</sup> The Asian Development Bank (ADB) recently completed a regional private sector assessment (PSA)<sup>2</sup> for Pacific developing member countries (PDMCs). The PSA concluded that PDMCs' financial markets do not mediate effectively between savers and investors; the weak institutions associated with collateralizing and collecting debts exclude many from the financial system. Accordingly, improving the environment for private sector development (PSD) through more efficient financial intermediation by enhancing the security and transferability of property rights was included as a key result area in the draft ADB Pacific strategy for 2005–2009.

2. The regional technical assistance (TA)<sup>3</sup> is designed to support PSD in selected PDMCs in line with ADB's PSD Strategy.<sup>4</sup> A similar TA was successfully completed for Vanuatu in March 2004,<sup>5</sup> and the lessons learned have contributed to the design of this regional TA. The TA framework is in Appendix 1.

## II. ISSUES

3. The financial sectors of PDMCs are underdeveloped and financial intermediation is limited. Banking services seldom reach beyond the main urban areas and have little outreach to low-income households and indigenous entrepreneurs involved in such activities as agriculture and fishing. Lending occurs only where it is possible to obtain collateral, but the systems for using property as collateral are cumbersome, expensive, and often unavailable. The underdevelopment of the financial sector is, among other factors, mainly connected to two important and related issues: (i) adverse implications of the customary land tenure system and (ii) lack of an effective secured transactions framework.<sup>6</sup> Land rights and the difficulty in using land as collateral for loans in the Pacific are contentious issues with deep-seated cultural implications requiring time and resources to solve.<sup>7</sup> To deepen financial markets and improve financial intermediation, the ability to effectively use movable property (chattel) as collateral will be crucial to facilitate lending.<sup>8</sup> A well-functioning secured transactions system generates economic and social gains for creditors and debtors as it reduces transaction costs and improves access to credit. It effectively links savers and investors, and enhances credit intermediation. Broadly, the more and better the collateral offered by the borrower, the lower the interest rate, the longer the time to repay, and the larger the loan relative to income.

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<sup>1</sup> Forum Economic Action Plan, Pacific Islands Forum Economic Ministers meeting, Majuro, Marshall Islands, 11–12 June 2003.

<sup>2</sup> ADB. 2003. *Swimming Against the Tide—An Assessment of the Private Sector in the Pacific Region*. Manila.

<sup>3</sup> The TA first appeared in *ADB Business Opportunities* on 25 March 2004.

<sup>4</sup> ADB. 2003. *Private Sector Development Strategy*. Manila.

<sup>5</sup> ADB. 2003. *Technical Assistance to the Republic of Vanuatu for the Diagnostic Study for Improving Access to Affordable Credit in Vanuatu*. Manila (\$150,000).

<sup>6</sup> A secured transactions framework is the legal, regulatory, and technical system sanctioned by law to use property as collateral for loans.

<sup>7</sup> Activities to address the customary land issue are under way, partly supported by ADB, but the issue will not be supported by this RETA.

<sup>8</sup> ADB. 2000. *Law and Policy Reform at the Asian Development Bank 2000*. Manila: ADB. (Volume II, Secured Transactions Law Reform in Asia: Unleashing the Potential of Collateral); World Bank. 1995. *Public Policy for the Private Sector*, "The Power of Collateral,"; European Bank for Reconstruction and Development. 2002. *Ten Years of Secured Transactions Reform*; Inter-American Development Bank. Paul Holdan. 1997. *Collateral Without Consequence: Some Causes and Effects of Financial Underdevelopment in Latin America*. The Financier, Vol 4.

4. Financial markets in the Pacific region are not effective in supplying capital to enterprises and are biased against smaller enterprises, sole proprietorships, rural business, and the ability of indigenous people to finance their investments and businesses. This situation appears not to be the result of the unwillingness of most financial institutions in the region to engage in business financing, but a function of perceived high risk resulting from the lack of effective use of collateral. Through the creation of a security interest,<sup>9</sup> a lender can be granted undisputed priority in collecting against certain property of the borrower (secured interest), with a legal system that permits the secured party to recover and sell the property in a timely manner. To deepen financial intermediation, PDMCs face the challenge to (i) legally define rights in both fixed and movable property; (ii) simplify procedures for identifying claims against movable property; (iii) implement procedures for repossessing pledged property in the event of default that remove the requirements for obtaining judgments through the courts; (iv) improve enforcement; and (v) develop and implement an effective registration system. A well-functioning secured transactions system would permit farmers, consumers, and businesses to use movable property as collateral for loans and thus generate economic and social gains for creditors and debtors, reduce transactions costs, and improve access to credit.

5. Experience in other countries has shown some lessons on how to achieve successful secured transactions reforms.<sup>10</sup> One lesson is that an effective secured transactions framework should embody several key elements, the most important of which are the following:

- (i) **Creation.** The process by which the creditor establishes a security interest in property (the collateral) must allow for the use of all economically important property, transactions, and agents. In addition, the law must permit creation at a low cost relative to the value of the transaction.
- (ii) **Priority.** The process that establishes the order in which claims against the collateral will be paid must set out clear rules for ranking the security interest against all other claims against the collateral. In so doing, it must provide rules for unambiguous ranking of priority and protect the secured party from hidden claims of third parties, including other secured creditors, unsecured creditors, a trustee in bankruptcy, some purchasers of the collateral, labor claims, and government tax claims.
- (iii) **Publicity (registration).** The process that the law specifies to make public the ranking of priority of the security interest must permit a potential lender to establish a ranking of priority against the collateral by filing a notice of security interest in a publicly available, preferably web-based, filing archive. It must also permit a potential lender to easily search the archive to determine whether other claims exist against a borrower's property. The process must be fast and affordable.
- (iv) **Enforcement.** This is the process by which, upon the debtor's default, the creditor can seize collateral or evict tenants in cases where real estate leases have been pledged as collateral. Once collateral is seized, it must be simple to sell it to pay off the debt. Such sale must take place quickly relative to the economic life of the property, and cost little in relation to the value of the transaction secured with such property.

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<sup>9</sup> A claim on property as collateral for loans.

<sup>10</sup> For example, the United States of America, most Canadian provinces, and Romania have adopted a low-cost, self-sustainable notice filing system. Creditors obtain information directly from the database where security interests are electronically filed.

6. This TA will draw on lessons learned and international best practice. Four PDMCs that had been invited to take part—Fiji Islands, Papua New Guinea, Marshall Islands, and Solomon Islands—have confirmed their participation. The TA will include a diagnostic review of the underlying issues in each country, as well as recommendations for the design and implementation of the envisaged reforms for a secured transactions framework and system. Subject to continued strong government support, the TA will subsequently lead to a series of country-specific follow-on TAs, which will implement the TA recommendations of the regional TA and promulgate an effective secured transactions system. This has already been foreseen in the Country Strategy Program Updates for Solomon Islands and Marshall Islands.

7. Building on existing PSD-related economic and sector work undertaken by ADB and others [four individual PSAs for Marshall Islands (May 2003), Papua New Guinea (June 2003), Samoa (May 2003), Vanuatu (May 2003)] in the Pacific islands, the TA will also provide focused analytical work on selected issues related to financial sector and legal and regulatory reforms, if establishing an enabling environment for enhanced financial intermediation is deemed relevant. These outputs will—to the extent possible—be linked to existing or prospective ADB assistance activities in PDMCs.

### **III. THE TECHNICAL ASSISTANCE**

#### **A. Purpose and Output**

8. The purpose of this TA is to design and agree with Government on a sound secured transaction reform package in each participating PDMC and prepare them for implementation with the ultimate goal of improving the access of the private sector to affordable credit. The regional TA is designed to leverage the country-specific TA program. It will have two components.

9. The first component aims to produce a sound road map for establishing a legal and regulatory framework for secured transactions in each of the four participating PDMCs. It will have the following outputs: (i) diagnostic review of the existing legal, regulatory, and institutional framework for security interests; (ii) recommendations for establishing a registration system or filing archive for security interests, including its design, establishment, location, and operation; and (iii) confidence building among stakeholders.

10. The second component will produce assessments of selected financial sector issues. Flexibility will be required, so as to be able to respond on an as-needed basis as relevant issues arise. PDMCs participating in this component will not necessarily be identical with those selected for component 1.

#### **B. Methodology and Key Activities**

11. The diagnostic studies for secured transactions (component 1) will: (i) prepare an overview of the existing legal and regulatory framework for security interests; (ii) identify policy issues in creating, prioritizing, publicizing, and enforcing secured interests, and make related recommendations for the implementation phase; (iii) pin point institutional considerations in establishing, locating and operating the registration system or filing archive, and recommend how the system should be structured; (iv) prepare a medium-term action plan for developing an inclusive secured transactions system, including required investment and capacity building activities; (v) identify and assess associated areas that require reforms and could be added to a comprehensive reform package in support of improving access to affordable credit; (vi) set out a

reform road map for secured transactions projects in each country specifying the necessary steps to introduce an effective system of pledging movable property as collateral, with details on linkages and sequencing of reform components; (vii) address as necessary, PSA and financial sector assessment related to financial intermediation; and (viii) present the findings and suggestions for reform to senior government officials, legal practitioners, lending institutions, and private sector representatives in each of the studied countries.

12. Assessments of selected financial sector issues (component 2) on an as-needed basis will complement the activities under component 1.

### **C. Cost and Financing**

13. The total cost of the TA is estimated at \$870,000 equivalent. The TA will be financed on a grant basis by the Japan Special Fund, funded by the Government of Japan. Detailed cost estimates and the financing plan are in Appendix 2.

### **D. Implementation Arrangements**

14. The Pacific Department, ADB, will be the Executing Agency for the TA. For the diagnostic studies for secured transactions (component 1), each participating government will appoint a senior official, acceptable to ADB, as project director to manage the day-to-day activities of the TA and coordinate with other agencies and concerned parties through a committee of stakeholders comprising government, legal practitioners, and representatives from lending institutions. Each participating government will provide logistical support to the consultants by providing necessary data and facilitating consultations.

15. The TA will be implemented over about 24 months. It is expected to start in November 2004, with completion in November 2006. Under component 1, the TA will require for each study country (i) international private sector development specialist (2 person-months), (ii) international secured transactions specialist (2 person-months), and (iii) a domestic legal expert (1.5 person-months). Component 1 will therefore require international consulting services of 24 person-months to be recruited through a consulting firm. Under component 2, 8 person-months will be required for financial sector assessments, to be undertaken by individual consultants. All consultants will be engaged by ADB in accordance with its *Guidelines on the Use of Consultants* and by quality-and cost-based selection and other arrangements satisfactory to ADB. The outline terms of reference are in Appendix 3.

16. The team leader of component 1 will submit to ADB a concise inception report shortly after the first visit to each participating country, and the draft final report after 14 months of implementation. As appropriate, the team leader will return to each country to present and discuss the draft final report with the respective governments and stakeholders. The final report, incorporating comments received, will be submitted to ADB and the governments involved within 17 months of the start of the TA. The consultant will submit three copies each of the draft final and final reports to ADB and six to each government. The final report will also be submitted on CD-ROM.

## **IV. THE PRESIDENT'S DECISION**

17. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$870,000 on a grant basis for Diagnostic Studies for Secured Transactions Reforms in the Pacific Region, and hereby reports this action to the Board.

## TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p><b>Goal</b></p> <p>Improved access of the private sector to affordable credit in Pacific developing member countries (PDMCs)</p>	<p>Increased credit to private sector as % of Gross Domestic Product</p> <p>Reduced interest rate spreads</p> <p>Lower transaction cost for credit provision</p>	<p>National gazettes, economic and financial sector reports, private sector assessments</p>	
<p><b>Purpose</b></p> <p>Formulate sound secured transactions reform packages in participating PDMCs, and assess selected financial sector issues in the Pacific islands</p>	<p>An agreed upon reform road map for each participating PDMC, setting out the design and implementation arrangements for the secured transactions reform package</p>	<p>Memoranda of understanding between government and Asian Development Bank (ADB) on the secured transactions reform packages</p>	<p>Continued commitment of government and policy makers to implement proposed reform package</p> <p>Responsiveness of lenders and borrowers to reform package</p> <p>Seamless transition from regional technical assistance (TA) to country-specific follow-on TAs for implementing the reform package</p>
<p><b>Outputs</b></p> <p>Component 1:</p> <p>1.1 Diagnostic reports on the existing legal, regulatory, and institutional framework for security interests</p> <p>1.2 Diagnostic reports on the establishment of an effective filing archive (registry) for secured transactions, including its design, establishment, location, and operation</p> <p>1.3 Confidence built among stakeholders</p> <p>Component 2:</p> <p>2.1 Diagnostic reports on selected financial sector issues in the Pacific islands</p>	<p>1.1 Reports accepted by governments and ADB, and submitted within 18 months of the start of the TA</p> <p>1.2 Reports accepted by governments and ADB, and submitted within 18 months of the start of the TA</p> <p>1.3. Effective demand for secured transactions reforms</p> <p>2.1 Diagnostic reports submitted to ADB within 24 months of the start of the TA</p>	<p>1.1 Communications between governments and ADB, ADB mission reports, and consultant reports</p> <p>1.2 Communications between governments and ADB, ADB mission reports, and consultant reports</p> <p>1.3 Survey of stakeholders (by consultants and ADB review missions)</p> <p>2.1 Consultant reports and ADB mission reports, as appropriate</p>	<p>Agreed upon reform road maps to be taken by governments and ADB for country-specific implementation</p>
<p><b>Activities</b></p> <p>Component 1:</p> <p>1.1 Assess existing legal</p>	<p>TA consultants' fieldwork</p>	<p>Consultant reports, ADB</p>	

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Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>and regulatory framework for secured transactions Identify and assess policy issues related to secured transactions</p> <p>1.2 Identify and assess institutional issues (establishment, location, operation) for an effective and cost-efficient filing archive (registry) for secured transactions, including investment requirements and capacity building needs</p> <p>1.3 Continuous dialogue with stakeholders, and presentation of findings</p> <p>Component 2:</p> <p>2.1 Carry out assessments of selected financial sector issues</p>	<p>and research between the start of the TA and its completion 24 months later</p>	<p>review missions</p>	
<p><b>Inputs</b></p> <p>ADB consultants</p> <p>Counterpart facilities</p>	<p>24 person-months of international consulting services. \$870,000, ADB financing.</p>	<p>ADB project disbursement documents</p>	<p>Successful recruitment and fielding of qualified consultants</p>

**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

<b>Item</b>	<b>Total Cost</b>
<b>Asian Development Bank (ADB) Financing<sup>a</sup></b>	
1. Consultants (Component 1)	
a. Remuneration and Per Diem	
i. International Consultants	360.0
ii. Domestic Consultants	40.0
b. International and Local Travel	127.0
c. Reports and Communications	10.0
2. Consultants (Component 2)	
a. Remuneration and Per Diem-International Consultants	185.0
b. International and Local Travel	70.0
c. Reports and Communications	6.0
3. Workshops/Consultations	20.0
4. Miscellaneous Administration and Support Costs	8.0
5. Contingencies	44.0
<b>Total</b>	<b>870.0</b>

<sup>a</sup>Financed by the Japan Special Fund, funded by the Government of Japan.  
Source: ADB estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. In each of the four participating Pacific Developing Member Countries (PDMCs), the consultants will establish the extent to which a secured transactions framework<sup>1</sup> is needed, and design and formulate a sound reform package for establishing a secured transactions framework and system.

2. The consultants will ensure that all works and outputs under the technical assistance (TA) comply fully with all relevant Asian Development Bank (ADB) policies and guidelines. The consultants' work will include, but will not be limited to, the following tasks.

### 1. International Private Sector Development Expert-Team Leader

3. The private sector development expert will have a master's (and, preferably, a PhD) degree in economics, business administration or a similar field. The expert will have extensive experience in the analyzing enabling conditions for private sector development and growth; institutional foundations of financial markets; finance for micro, small, and medium-scale business development; and property rights and their impact on economic development. The consultant will undertake the following specific tasks in each of the participating PDMCs:

- (i) In cooperation with the secured transactions specialist, identify policy issues—as they relate to entrepreneurial incentives and the institutional foundations of financial markets—in creating, prioritizing, publicizing and enforcing of security interests.<sup>2</sup> Formulate related recommendations for the implementation phase.
- (ii) Assist the secured transactions specialist in reviewing existing public registries and identifying areas in which they can be used or integrated in a framework for secured transactions. Cite institutional considerations in establishing, locating and operating an effective and cost-efficient registration system.
- (iii) Together with the secured transactions specialist, develop a medium-term action plan for developing a secured transactions system.
- (iv) Identify and assess associated areas that require reforms and could be added to a comprehensive reform package in support of improving access to affordable credit. Develop a strategic reform action plan and integrate in the reform package.
- (v) Formulate a road map for a proposed reform package to improve access to affordable credit, including a detailed action plan for implementing a series of TAs to support the implementation of proposed reforms, with due consideration of ADB TA requirements. Include recommendations on the preferred sequencing of the proposed reform package.
- (vi) To support the recommended reforms, and build confidence and promote ownership among key national stakeholders and identify appropriate counterpart government agencies for each proposed TAs
- (vii) Prepare and submit reports as required by ADB. Liaise closely with ADB and local stakeholders, including the implementing agencies in each country.

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<sup>1</sup> The legal, regulatory, and technical system sanctioned by law to use property as collateral for loans.

<sup>2</sup> A claim on property as collateral for loans.

## 2. International Secured Transactions Expert

4. The secured transactions expert will have a master's degree (and, preferably, a PhD or equivalent) in law, economics, or a related area. The expert will have extensive international experience in developing or utilizing legal and regulatory secured transactions frameworks, and knowledge of the institutional (and, to some extent, technical) requirements for the establishing a registration system, showing its relation to the legal framework. The consultant will undertake the following specific tasks in cooperation with the private sector development expert-team leader:

- (i) Prepare an overview of the existing legal and regulatory framework for security interests.
- (ii) Identify policy issues in creating, prioritizing, publicizing, and enforcing secured interests. Formulate related recommendations for the implementation phase.
- (iii) Review existing public registries and identify areas in which they can be used or integrated in a framework for secured transactions. Cite institutional considerations in establishing, locating and operating a registration system.
- (iv) Assist the private sector development expert-team leader in making a medium-term action plan for developing a comprehensive secured transactions system.
- (v) Assist the private sector development expert in identifying and assessing related areas that require reforms and could be added to a comprehensive reform package in support of improving access to affordable credit.
- (vi) Together with the team leader, formulate a road map for a proposed reform package to improve access to affordable credit, including a detailed action plan for implementation.

## 3. International Legal Expert

5. The international legal expert should have an advanced law degree and be licensed to practice law in at least one Civil Code or one Common Law jurisdiction. The expert should have extensive knowledge of the issues relevant to an effectively functioning secured transactions framework; extensive experience as evidenced by publications in legal journals in drafting reports on how problems in the framework for secured transactions limit access to credit in developing countries; experience in preparing draft laws on secured transactions and drafting administrative and technical regulations for secured transactions systems; and managerial experience in legal reform and establishment of registries and filing systems in developing countries. Because of the need to get different perspectives on these issues from international legal experts and depending on the legal drafting recommendations, the consulting firm will be expected to complement legal expertise with specialized legal areas, as required, and in agreement with the Asian Development Bank (ADB).

6. The International legal expert shall undertake the following tasks:

- (i) Make a preliminary review of the relevant laws of each participating country at the outset of the project, and give indication of the extent to which such laws are consistent with an effective and cost-efficient secured transactions framework and system.

- (ii) Collaborate with the secured transactions expert in devising legal drafting approaches to the problems identified by the secured transactions expert and the PSD expert. In suggesting options, the expert will identify best practices in other countries and collaborate with the secured transactions and PSD experts in adapting such practices to the constraints in each participating country.
- (iii) Draft sections of reports dealing with the legal findings of the project.
- (iv) Make presentations on international approaches relevant to the problems of each participating country.