

**ASIAN DEVELOPMENT BANK**

**TAR: VAN 36407**

**TECHNICAL ASSISTANCE**  
(Cofinanced by the Government of Australia)

**TO THE**

**REPUBLIC OF VANUATU**

**FOR**

**SECURED TRANSACTIONS REFORMS**

**December 2004**

## CURRENCY EQUIVALENTS

(as of 14 October 2004)

Currency Unit	–	vatu (Vt)
Vt1.00	=	\$0.0089
\$1.00	=	Vt112.41

## ABBREVIATIONS

ADB	–	Asian Development Bank
IT	–	information technology
MFEM	–	Ministry of Finance and Economic Management
PSA	–	private sector assessment
PSD	–	private sector development
UK	–	United Kingdom
USP	–	University of the South Pacific
TA	–	technical assistance
TOR	–	terms of reference

## TECHNICAL ASSISTANCE CLASSIFICATION

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

## GLOSSARY

Security interest	–	A claim on property as collateral for loans
Company charge	–	A security interest provided by the Company Law that may be created against the assets of a company
Secured transactions framework	–	The legal, regulatory, and technical system sanctioned by law to use property as collateral for loans

## NOTES

- (i) The fiscal year of the government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

This report was prepared by W. Wicklein.

## I. INTRODUCTION

1. During country programming in 2003, the Government of Vanuatu requested technical assistance (TA) from the Asian Development Bank (ADB) to address the lack of access to affordable credit in the country. Based on the findings and recommendations of a private sector assessment (PSA) for Vanuatu,<sup>1</sup> it was agreed with the Government that a comprehensive reform of the country's secured transactions framework should be considered.<sup>2</sup> In November 2003, ADB approved a small-scale technical assistance (TA) for a diagnostic study to improve access to affordable credit in Vanuatu. The TA's purpose was to prepare a sound integrated reform package, including a detailed implementation plan, to assist the Government in preparing a comprehensive reform plan for the development of a secured transactions framework with a view to improve access to affordable credit.<sup>3</sup>

2. An ADB Mission presented the findings and recommendations to the Government in March 2004. The Government reconfirmed its request for ADB TA to assist in developing a secured transactions framework, and understanding was reached on the objective, scope, implementation, financing arrangements, and terms of reference for the TA. The TA framework is in Appendix 1.

## II. ISSUES

3. Vanuatu's private sector has developed at a disappointingly slow rate, partly because financial underdevelopment hinders adequate financing of the private sector. Vanuatu's domestic financial sector<sup>4</sup> provides only a minimal range of banking services, access to credit for local (Ni-Vanuatu) entrepreneurs is limited, and high interest rate spreads reflect high transaction costs and risk premiums and inefficiencies in financial intermediation. ADB's PSA for Vanuatu suggests that the underdevelopment of the financial sector is, among other factors, connected to two important and related underlying issues: lack of a secured transactions framework (i.e., the legal framework that governs collateral for loans), and adverse implications of the customary land tenure system. These elements effectively prevent the use of collateral to bridge the gap between credit supply and demand, thereby impeding access to affordable credit especially for the Ni-Vanuatu.

4. Land and real estate often cannot serve as collateral in Vanuatu since large parts of the land are difficult to mortgage because of customary laws governing ownership and use of land. While some initial progress in land reform is being made, these reforms will become fully effective only in the longer term.<sup>5</sup> In the meantime, using movable property as collateral will be crucial to promote access to lending to business borrowers in Vanuatu.

5. A system of securing movable assets (chattels) is fundamental in developing an effective market for credit. Through the creation of a security interest, 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. A

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<sup>1</sup> ADB. 2002. *Technical Assistance for Private Sector Development Strategy for the Pacific*. Manila.

<sup>2</sup> The TA first appeared in *ADB Business Opportunities* (Internet edition) on 19 February 2004.

<sup>3</sup> ADB. 2003. *Technical Assistance to the Republic of Vanuatu for Diagnostic Study for Improving Access to Affordable Credit in Vanuatu*. Manila.

<sup>4</sup> The tax-free status of exempt and international financial organizations registered in Vanuatu's offshore financial center prohibits them from domestic activities in Vanuatu.

<sup>5</sup> Land tribunals are being developed under legislation passed in 2002 and have the potential to help significantly in resolving land disputes. Also passed in 2003 were strata title legislation and the Valuation of Land Act.

well-functioning secured transactions system generates economic and social gains for creditors and debtors, as it reduces transaction costs and improves access to credit. Other medium- to long-term benefits include improved financial discipline, and the reduction in adverse selection of borrowers, with ensuing improved allocation of capital and economic growth. 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.

6. An effective legal framework for secured transactions will permit farmers, consumers, and businesses to use movable property as collateral for loans. Such a legal system should embody several key elements, the most important of which are the following: (i) 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, at a low cost relative to the value of the transaction; (ii) the process that establishes the order in which claims against the collateral will be paid must set out clear rules for the ranking of the security interest against all other claims against the collateral; (iii) 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 the security interest in a publicly available archive (registry); and (iv) the process by which, upon the debtor's default, the creditor can seize collateral, and sell it quickly and at low transaction cost relative to the value of the transaction secured with such property.

7. Vanuatu's current legislation does not meet the necessary conditions that would allow for the inexpensive and predictable use of movable property as collateral. The framework for lending that meets the standards for effective creation, priority, publicity, and enforcement of security interests is not in place. While it is possible to use some forms of collateral, the process is costly, inefficient, and risky to lenders—the existing framework does not permit the effective use of collateral as security for loans or other forms of credit. The existing legal framework effectively excludes sole proprietorships from using collateral to access credit. Aside from some limited financing of automobiles available to buyers living in towns and a charge taken against some large companies, under the current framework banks do not often finance equipment and dealers rarely sell on credit. A very limited number of security interests have been registered in the country's various relevant registries.

8. Such a gap has had adverse economic consequences for Vanuatu. It hinders the country from exploiting its comparative advantages and results in a loss of high-value export opportunities. The current system inhibits the growth of businesses, harms productivity, especially disadvantages those (primarily Ni-Vanuatu) who wish to operate as sole proprietors, and effectively exacerbates the disadvantages of the wide geographic area that Vanuatu occupies. A more detailed description of the problems in Vanuatu's legal framework for secured transactions is in Appendix 2.

9. While foreign laws can serve as models and illustrate principles, they should not be introduced wholesale in Vanuatu. As many in the Vanuatu business community have learned, foreign statutes often do not function effectively in Vanuatu in practice because they may contain provisions that are not relevant to the local situation. Accordingly, this TA calls for building the applicable law from the ground up so as to give it a structure that reflects the local environment and maximizes the economic impact in Vanuatu.

10. Real estate issues are still subject to substantial political debate and will not be included in the first reform because of their sensitive nature and the fact that real estate ownership outside urban areas is, in many cases, still subject to a customary law that raises uncertainties both in the ability of ostensible owners to pledge real estate and in the ability of a lender to repossess in the event of default. This TA will therefore consider all property except real estate and leases on real estate as potential collateral. Later efforts will consider expanding the reform to include real estate.

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

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

11. The goal of this TA is to increase and broaden access to credit in Vanuatu. The purpose is to assist the Government in establishing a well-functioning secured transactions framework tailor-made for the Vanuatu context. Toward this end, the TA will (i) establish the legal and regulatory framework for secured transactions, (ii) operationalize an Internet-based notice filing archive for secured transactions, and (iii) build supplemental capacity in relation to the economic and legal application of the secured transactions framework, as well as public awareness with respect to credit based on the expanded use of collateral.

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

12. The methodology rests on an economic analysis of the law; the application of best international practice to the specific situation in Vanuatu; and undertaking the work in synchronized and integrated phases involving technical, legal, and economic inputs. This methodology will ensure tight integration of the legal and technical frameworks. It will also permit developing clear economic justification for each proposed legal change, to motivate policymakers and to minimize disagreements over legal issues. All major sections and some individual chapters of draft laws and regulations will be annotated to explain their intended economic consequence.

13. The TA will take into account the relatively low level of in-country capacities to apply the reformed secured transactions framework. Relevant legal and technical institutions will be designed accordingly; and legislators, government and private practice lawyers, possibly legal faculty members of the University of the South Pacific (USP), and banking practitioners will be given training in implementing and, as necessary, amending the legal, regulatory, and technical systems.

14. The TA will consist of three components:

- (i) Component 1 (legal and regulatory reforms) encompasses economic and legal activities to be undertaken to establish a comprehensive and effective secured transactions framework. The activities will include abrogating and superseding existing legislation governing all aspects of lending that are related to collateral, including registries and enforcement.
- (ii) Component 2 (notice filing archive) involves the design and development of an Internet-based notice filing archive (on a turnkey basis), including the associated technical and administrative regulations, and operation and maintenance for the initial 12 months of operation. The archive could be administered by local non-

government organizations with a not-for-profit core operation (server, database) and for-profit supply of registration services by lawyers, banks, and other qualified and interested groups. The mode of operation will be set out in the regulations of the filing archive, whose drafting is part of the TA. The archive's operating cost should be low and its design simple to ensure the greatest degree of sustainability.<sup>6</sup> The archive will be designed in a way that facilitates easy monitoring of basic statistics (such as volume of entries, type of collateral being used, provincial distribution of filings, nature of the lender, and nature of the borrower) to permit a broad quantitative and qualitative assessment of the quality of the reform.

- (iii) Component 3 (capacity building, public awareness, and performance monitoring) will supplement and overlap with components 1 and 2 and will provide supplemental training, public awareness, and monitoring support. In particular, it will help strengthen local capacities in implementing and amending the legal and regulatory framework, as well as applying the technical systems. Materials for dissemination will target policymakers, local lawyers, lending institutions, borrowers, and other stakeholders. Monitoring of results will be based on examinations of filings and interviews with local businesses, both borrowers and lenders.

15. Active engagement and participation of stakeholders and policymakers will be ensured for the duration of the TA. Drafts of all analytical reports, laws, and regulations will be circulated for comments and an exchange of views encouraged. Based on comments received and subject to economic analysis, revisions will be incorporated into the law, the regulations, and the core filing system in a second draft that will be further discussed with both private and public sectors. Part of the process will be to undertake presentations before legislative commissions and representatives.

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

16. The TA is estimated to cost \$1,000,000 equivalent, including foreign exchange of \$725,000 and local currency of \$275,000 equivalent. ADB will provide \$800,000 equivalent covering the entire foreign exchange cost of \$725,000 and \$75,000 equivalent of the local currency cost on a grant basis, of which \$600,000 will be financed by ADB's TA funding program and \$200,000 by the Government of Australia, to be administered by ADB. The Government of Vanuatu will contribute \$200,000 equivalent for office space and facilities, counterpart staff and legal support services, and local workshops and seminars. Detailed cost estimates and the financing plan are in Appendix 3.

### **D. Implementation Arrangements**

17. The Ministry of Finance and Economic Management (MFEM) will be the Executing Agency for the TA project. Close cooperation will be required with the Attorney General's Office at the State Law Office. Both agencies will appoint one senior staff each, on a part-time basis, to facilitate and actively support the reform activities to be undertaken under the TA. The

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<sup>6</sup> Monthly operating costs of the archive could be in the range of \$150–250 per month if it uses rented servers and contracts out server maintenance.

substantive role of these agencies will be to (i) facilitate the finalization of the draft law, including regulation, and its discussion and passing by the legislature; (ii) support the process for passage of the administrative and technical regulations for the notice filing system; (iii) participate in discussions of policy papers, law and regulations/systems; (iv) facilitate meetings and presentations for raising awareness; and (v) implement and amend the legal, regulatory, and technical framework as required. The counterpart agencies will provide adequate office space and facilities for consultants. A secured transactions reform committee, co-chaired by senior officials of MFEM and the State Law Office, and including legal and lending practitioners, as well as possibly legal USP faculty members, will be established to drive the reform process for the duration of the TA.

18. The TA will begin around March 2005 and be implemented over 36 months (expected completion in February 2008). An international consulting firm (the consultant) will be selected and engaged by ADB using the quality- and cost-based selection method in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. The TA will require about 31 person-months (24 international and 7 domestic) of consulting services. The consultant team (31 person-months) will include an international secured transactions expert (7), an international private sector development expert (4), one or more international legal experts as appropriate (7), an international technical filing archive expert (6), and local lawyers (7). It may be necessary to provide international expertise in specialized legal areas, in agreement with ADB. The outline terms of reference for the consultant team for each phase are in Appendix 4.

19. In phase 1, the consultant will submit an inception report including a detailed work plan and conceptual issues relevant to project delivery 1 month after completing the first field visit to the first study country. Major project milestones include (i) submission of the first draft of a comprehensive secured transactions law and associated regulations (6 months after TA inception); (ii) finalization of the core system (demonstration sample) for the notice filing archive (6 months); (iii) submission of the final draft law and regulations (3 months after receipt of final comments from Government and stakeholders); (iv) passing and gazetting of the law and regulation; (v) implementation of the filing archive (finalization and demonstration of the core system) 2 months after passage of the law; and (vi) completion of the consultant's running and maintaining the filing archive for the initial 12 months of its operation. The consultant will submit quarterly reports to ADB, MFEM, and the State Law Office. Brief progress reports will be submitted to ADB 2 weeks after each substantial field visit. A comprehensive final draft report will be submitted within 6 weeks of completion of project activities. The final report will be submitted 4 weeks after receipt and incorporation of comments from ADB and government counterparts.

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

20. The President, acting under the authority delegated by the Board, has approved (i) ADB administering a portion of technical assistance not exceeding the equivalent of \$200,000 to be financed on a grant basis by the Government of Australia; and (ii) ADB providing the balance not exceeding the equivalent of \$600,000 on a grant basis, to the Government of Vanuatu for Secured Transactions Reforms, 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> <ul style="list-style-type: none"> <li>• Increase and broaden access to credit</li> </ul>	<ul style="list-style-type: none"> <li>• Increased credit to private sector (in percent of gross domestic product)</li> <li>• Reduced interest rate spread</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly economic reviews and annual reports of Reserve Bank of Vanuatu</li> <li>• International finance statistics</li> </ul>	
<p><b>Purpose</b></p> <ul style="list-style-type: none"> <li>• Establish a well-functioning secured transactions framework</li> </ul>	<ul style="list-style-type: none"> <li>• Increased number of loans against collateral</li> <li>• Increased number of types of financial institutions recording security interests</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly economic reviews and annual reports of Reserve Bank of Vanuatu</li> <li>• Survey of credit providers (ADB)</li> <li>• Private sector assessments (ADB)</li> </ul>	<ul style="list-style-type: none"> <li>• Government's continued commitment to and support of reform package</li> <li>• Lending institutions' and other creditors' continued support and acceptance of proposed reform package</li> <li>• Sustained operations by filing archive operator</li> <li>• Legal capacities in government and private sector adequate to implement and maintain the reformed secured transactions framework</li> </ul>
<p><b>Outputs</b></p> <ul style="list-style-type: none"> <li>• Legal and regulatory framework for secured lending established</li> <li>• Filing archive for secured transactions established</li> <li>• Supplemental capacity built, public awareness, and monitoring support</li> </ul>	<ul style="list-style-type: none"> <li>• Draft laws delivered by end of 2005, and passed by Parliament by mid- 2006</li> <li>• Internet-based notice filing archive operational, including technical and administrative regulations by mid-2006</li> <li>• Legal practitioners, lenders, and filing archive operators trained by 2006; initial operation of filing archive supported for 12 months following passing of the legal framework</li> </ul>	<ul style="list-style-type: none"> <li>• State Law Office and Reserve Bank reports, Parliamentary reports</li> <li>• Consultant's technical reports, press and government reports</li> <li>• Consultant and ADB mission reports; survey/feedback from lending institutions, legal practitioners, and operator of filing archive</li> </ul>	<ul style="list-style-type: none"> <li>• Recommendations made in the output reports are acceptable to Government and ADB.</li> <li>• Adequate notice filing archive operator can be identified and mobilized.</li> </ul>

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<b>Design Summary</b>	<b>Performance Indicators/Targets</b>	<b>Monitoring Mechanisms</b>	<b>Assumptions and Risks</b>
<p><b>Activities</b></p> <ul style="list-style-type: none"> <li>• Economic and legal analysis of the existing legal framework for secured transactions</li> <li>• Development of a legal and regulatory framework for secured lending, including drafting of legislation</li> <li>• Design and development of an Internet-based notice filing archive</li> <li>• Development of the technical and administrative regulations governing the notice filing archive</li> <li>• Initial operation and maintenance of the filing archive for the first 12 months of operation</li> <li>• Provision of supplemental training, public awareness, and monitoring support</li> </ul>	<ul style="list-style-type: none"> <li>• TA consultant's field and home work and study between August 2004 and July 2007</li> </ul>	<ul style="list-style-type: none"> <li>• Consultant milestone, quarterly and progress reports</li> <li>• Tripartite meetings</li> <li>• ADB mission report</li> <li>• Government reports</li> <li>• Stakeholder consultations</li> </ul>	<ul style="list-style-type: none"> <li>• Notice filing archive operator can be identified and mobilized.</li> <li>• Continued support of activities from Government, lending institutions, and other stakeholders.</li> <li>• Political environment is conducive to passing legal reforms.</li> </ul>
<p><b>Inputs</b></p> <ul style="list-style-type: none"> <li>• ADB consultants</li> <li>• Counterpart facilities</li> </ul>	<ul style="list-style-type: none"> <li>• 24 person months of international and 7 person months of domestic consulting services</li> </ul>	<ul style="list-style-type: none"> <li>• ADB project disbursement documents</li> </ul>	<ul style="list-style-type: none"> <li>• Successful recruitment and fielding of qualified consultants</li> </ul>

## **ECONOMIC, LEGAL, REGULATORY, AND TECHNICAL FRAMEWORK FOR ASSISTANCE**

1. The legal, technical, and regulatory content of the terms of reference (TOR) activities will address the following principles and problems in secured transactions that have been identified in Vanuatu. They will also follow the main terms for assistance set out here, as well as in the body of this proposal, which have been developed from the preliminary work.

### **A. Economic Issues in Secured Transactions and Access to Credit**

2. The activities of this TOR will rest on the premise that the fundamental economic feature of collateral and the distinguishing trait of a secured lending system (a lending system that uses collateral) lies in granting priority to a lender or credit seller in collecting against some property of the debtor. A security interest is "a right of satisfaction" from the property—the "collateral"—to which the security interest is attached. If the debtor defaults, the collateral can be seized by the creditor, sold or exchanged, and the security interest of the secured creditor will be satisfied (paid) ahead of the general claims of unsecured creditors.<sup>1</sup>

### **B. Creation of Security Interests**

3. **Problems Found.** In Vanuatu, several problems arise in creating security interests in Vanuatu. These features increase risk, raise transactions costs, and reduce the value of property as collateral.

4. Vanuatu, following applicable laws from the United Kingdom (UK) and France, provides for an unreformed system for secured transactions dating back to the 1800s, which offers a fragmented system for creating security interests; several different laws and case law govern secured transactions. In Vanuatu, the French Civil Code provisions on pledge and mortgage govern creation of the pledge in movable property and the mortgage in titled real estate. But French law is virtually in disuse in Vanuatu.<sup>2</sup> Vanuatu also follows a UK law, which provides for the Company Charge. This device follows from the different versions of the British Companies Act, applying to security interests in the property of corporations. In addition, Vanuatu provides for the sale with retention of title under the Bills of Sale Regulation operating as part of the British law in force prior to Independence and continuing to operate thereafter, which applies to security interests granted by individuals over movable property. The provisions of the Land Leases Act deal with mortgages over leasehold titles.<sup>3</sup>

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<sup>1</sup> Moreover, the security interest of a secured creditor will be satisfied in the order of its priority among the other secured creditors that have a security interest against that same collateral. Without a security interest, a creditor is "unsecured." An unsecured creditor has only a general claim against a debtor's property, a claim that gives that creditor no better right to payment than any other unsecured creditor.

<sup>2</sup> For example, the three major retail banks providing finance in the jurisdiction are Anglophone Banks, and the lawyers who act on their behalf are all trained in common law systems as opposed to civil law systems.

<sup>3</sup> The laws of Vanuatu comprise a mix of (i) all Joint Regulations and subsidiary legislation in force immediately before the day of Independence, (ii) the British and French laws in force or applied in Vanuatu immediately before the day of Independence, and (iii) customary law, which will continue to have effect as part of the law of the Republic. (See article 95 of the Constitution.)

5. Taken together, those laws might superficially indicate that much property might serve as an object of security. However, the opposite is true. Gaps in coverage of transactors and transactions limit using secured transactions to obtain credit. Nor can more laws, on top of the existing ones, "fill" these gaps. For example, sale with retention of title and financial leasing may finance new equipment, but they cannot be used to finance used equipment, inventory in the hands of the debtor, account receivables, livestock or future crop. These, of course, are key activities in Vanuatu.

6. The company law is restrictive in that only a registered company—a corporation—can grant a debenture or floating charge over all of its present assets and future acquired assets. For corporations, this limited way to create security interests leads to high costs. For example, a company charge may be used only by incorporated companies. Since almost none of the businesses operated by local (Ni-Vanuatu) entrepreneurs or those businesses situated outside the major cities are corporations, a substantial amount of commercial activity takes place without the possibility of using pledges of assets to secure loans. Moreover, one lawyer reported that it would cost \$500–\$1,000 a year—a very substantial amount compared with the average income in the country—to incorporate and maintain a company in Vanuatu.

7. The Bills of Sale Regulation also restricts the ability of an individual to use collateral. Only a trader as defined in the Regulation can grant a Traders Bill of Sale. Security interests granted by traders by way of a Traders Bill of Sale can extend to "trade goods" acquired in the future. However the Traders Bill of Sale is limited to the trader's trade goods and cannot apply to all of the trader's assets. Moreover, the Bills of Sale Regulation requires that the purchased property be identified in a detailed manner.<sup>4</sup> Bills of sale, as opposed to Traders Bills of Sale, are much more specific in their requirements. The Bills of Sale Regulation in relation to the circumstances in which chattels may be seized also restricts taking collateral to secure the payment of sums of money or the performance "of any covenant or agreement contained in the Bill of Sale and necessary for maintaining the security."<sup>5</sup>

8. **Proposed Terms for Technical Assistance.** To achieve complete reform, the legal, regulatory, and technical activities will encompass drafting one comprehensive legal framework, regulations and filing system that governs all stages of a security interest: creation, priority, publicity, and enforcement. Partial reform is not cost-effective in Vanuatu. Similar assessments were made for unreformed industrial countries.<sup>6</sup>

9. A well-drafted system for creating security interests to secure loans lies at the heart of an effective law. The consultants' legal assistance will include designing a system that integrates all functionally identical security devices (leasing, trust, pledges, mortgages, hire purchase, and assignment of rights) into one comprehensive legal framework and filing system. This broader concept—a functional approach—will organize security interests along the lines of what actually serves as an instrument of security. Including also a broad coverage of all property, transactions and lenders will be assured of most beneficial economic impact. The law should not restrict lenders or descriptions of collateral in order to achieve most competitive credit market. Under the applicable laws of the UK, several authors have recommended a reform of the security interest law of UK that does not differentiate between companies and

<sup>4</sup> See Section 5 and Section 6 of the Bills of Sale Regulation.

<sup>5</sup> Section 8(1) Bills of Sale Regulation.

<sup>6</sup> For example, the United Kingdom Company Charge was partially amended and kept in effect because of the delays in setting up a security interest reform.

individuals. To permit and facilitate inventory financing, the new legal framework should permit parties to choose a security interest against "generally described" collateral. The law will not require that the security agreement or the court be required to specifically identify and order the seizure of the collateral. To meet standards for fast collection, crucial for the greatest economic benefit, the law should permit *continuation in proceeds* and set out clear rules for their recovery; these should supersede old narrow rules for tracing of proceeds.<sup>7</sup>

10. The consultants will draft revisions to any statutes or applicable regulations that, directly or indirectly, could impose costs on creating security interests. Finally, throughout the drafting process, the consultants will examine legal issues that discriminate between genders, and will ensure protection of women's rights in marital property in creating security interests. To minimize doctrinal dispute and motivate discussion and policymaker understanding, ample commentaries on the economic intent of the law's provisions will be supplied. This is particularly important where the content of the law departs from existing practice in Vanuatu.

### C. Ranking of Priority of Security Interests

11. **Problems Found.** The applicable statutes in Vanuatu do not govern the ranking of priority of claims among the different creditors. In an incomplete way, case law has set out principles governing the priority afforded to security interests as developed by the judges in English courts, and to the extent that there have been further developments in Vanuatu by the judges of Vanuatu courts. Moreover, for several items of collateral, the law specifies priority by filing in more than one registry system, and does not resolve which filing will have the legal force to set up the first priority (e.g., between the company charge and the bill of sale). In addition, some registry rules provide for priority by day of filing but not by hour, minute, and second. This system could give rise to fraudulent transactions.

12. There are also important legal gaps. For example, ship mortgages are used for vessels, but there is no legally designated register for the security interest. Even when the law provides that a registered security interest takes priority over an unregistered security interest, as in the case of floating charges, the time of priority is from the time of creation, with subsequent filing, and not from the time of filing. In other instances, priority is given to certain preferential creditors, which may include the Government with respect to taxes, employees with respect to wages, and other employee entitlements.

13. The nature of the security interest in respect to receivables is also unclear, as it is arguable that one cannot create a fixed charge over future debts. The difficulty with assignments over receivables is that the debtor who owes money to the bank's customer must be given notice of the security. If there is failure to give such notice, a subsequent security interest may acquire priority by reason of its having given notice to the debtor earlier in time.

14. **Proposed Terms for Technical Assistance.** To assure a uniform ranking of priority and eliminate the risk of hidden creditors, the TOR activities should place the priority rules in one law that applies to any and all interests in property, regardless of their form, that are entered into for purposes of security. Such a priority structure will ensure a competitive credit

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<sup>7</sup> As with all good drafting, the new law must rule as inapplicable or derogate all procedural and other rules that conflict with this principle. In those derogations, it must address the other public policy issues that arise when amending those laws. It must also add enforcement rules consistent with this principle.

market because it will cover all present types of security interests, including financial leases, consignments, and sales with retention of title, among others. This framework will not replace the existing special instruments. However, it will operate above them and impose a common system of priority. This will minimize the risk of hidden creditors that could be granted priority rights under a separate law.

#### D. Publicity of Security Interests

15. **Problems Found.** Multiple registries exist for different security interests, which provide for a “registry” system, as opposed to a notice filing system (paras. 17–20). For example, the Bills of Sale are registered at the Supreme Court of Vanuatu and the court keeps a register book. The Bill of Sale is simply lodged with the Supreme Court, which retains one copy and marks the entry in the Register. These registries do not provide remote public access. Company Charges are registered with the Registrar of Companies. An original copy of the Charge together with particulars of the Charge is lodged with the Registrar of Companies although only the particulars of a Charge document is retained by the Registrar. The original document is returned with notification of the registration endorsed thereon. Bills of Sale and Company Charges registered with the respective registries are usually returned within 2 days. However, in the case of leasehold mortgages, it can be months, sometimes up to 1 year, before registered documents are returned. No place is specified for filing the mortgage against ships and aircraft.

16. The cost of registration is high, not only due to inefficient registration systems but also because a regressive stamp tax is imposed on every registration: For example, a Bill of Sale is subject to the payment of stamp duty at 0.6% as well as the payment of registration fees of VT 5,000 (\$40.00). The Bills of Sale Regulation provides for proof of the execution. The practice in Vanuatu is to ensure that all Bills are executed by the grantor before a Magistrate who completes the proving provision. Charges granted by companies are not subject to the payment of any registration fees except in the case of international companies incorporated under the International Companies Act where a registration fee of \$100.00 is payable. Charges, as a form of loan security, are also subject to stamp duty of 0.6%.

17. **Proposed Terms for Technical Assistance.** In making public a security interest, sharp differences exist between the approach in Vanuatu that uses a registry of the entire security agreement with a broad government guarantee on one hand, and a modern system that uses notice filing, on the other. In a registration system, a lender registers the entire security agreement or a lengthy abstract of it. In a system of notice filing, the lender files only a “notice” of the existence of the security interest. The notice filing archive takes responsibility only for correctly entering the information provided by the lender in the notice and for maintaining the database and public access to it.

18. A notice filing system costs less and is more likely to produce sustainable reform.<sup>8</sup> The costs of filing the entire agreement in a registration system are high and are not standard; checking is complex and time-consuming. At the same time, in a registration system the state guarantee has little value because the state does not guarantee against error. Moreover, because so much information is filed in a registration system, public access as a practical matter is more difficult. Difficulty of access defeats the purpose of the filing system: making public such data.

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<sup>8</sup> The United States of America and most Canadian provinces have adopted this filing system; so has Romania. Creditors obtain information directly from the database where security interests are electronically filed.

19. The much less costly, notice-filing system requires only that creditors file a notice of the existence of the security interest. This notice contains the smallest amount of information necessary to permit third parties to learn that the creditor has created a security interest in certain property. Such a notice might include the names and domiciles of the parties, and a description of the collateral. Because the law requires simple and standardized information, simple databases can readily store it and make it public over the Web. Potential lenders can check existing security interests and other encumbrances on property by searching the filing system themselves.<sup>9</sup>

20. Because the differences in cost and sustainability are enormous,<sup>10</sup> the activities should set in place the underlying legal and regulatory requirements for a notice filing system.

21. Based on economic logic and experience, the TA activities will focus on private competitive supply of notice filing services rather than on a government-run solution.

## E. Enforcement of Security Interests

22. **Problems Found.** The core feature of an effective secured transactions system is the ability of the creditor, in the event of default by the debtor, to repossess and sell (or evict) the property that the debtor gave as collateral. However, lenders in Vanuatu face slow and expensive enforcement outside of the repossession of cars financed under the Bill of Sale and the collection of the floating charge when a company enters receivership.

23. **Proposed Terms for Technical Assistance.** The TOR activities should focus on the key legal elements for improving enforcement in secured credit, which lies in laws that permit nonjudicial repossession (when possible without disturbing the peace<sup>11</sup>) and that specify rapid ex parte court orders for forcible repossession. The activities should consider setting in place private and public agents who can carry out those orders. These court-administered methods should retain only those key steps required by most constitutions to use force for breaking and entering. Provisions for the sale of collateral, crucially, should permit creditor-administered sales conducted under commercially reasonable standards.<sup>12</sup> The TOR activities should focus on introducing such quick and less expensive collection mechanisms, at the same time that they

<sup>9</sup> Where lenders find notices filed, they can ask borrowers for evidence of the relevant security agreements or for authorization from the borrower to gather information directly from the debtor's other creditors.

<sup>10</sup> Differences in cost and sustainability are enormous: an Internet-based notice filing archive supported by the World Bank costs under \$500,000 to program and equip. Using rented servers and web-based programs, its monthly operating costs are about \$150, a cost easily sustainable by its private non-government organizations (NGO) operators. A real estate registry that files and verifies entire documents could cost millions. Private operators cannot sustain such costs. Indeed, even for the governments themselves, once external funding ends, these systems typically collapse again in endless backlog and out-of-date computer equipment.

<sup>11</sup> Called "harmless repossession" in reformed systems.

<sup>12</sup> Suitable measures, when properly drafted and explained, include legal instructions for summary court judgments (ex parte court orders); harmless repossession, wherein the lender can repossess collateral without court intervention; expanded private authority for repossession; expansion of public services to include some private incentives and competition. Suitable measures include penalties against public officials who do not carry out duties in conformity with law; these might be personal or they might involve automatic compensation from state funds for delays (e.g., a credit against taxes equal to the interest forgone on the uncollected debt). A suitable legal framework covers creditor-administered sale, sanctions for creditors that abuse that process, and a workable way to enforce those sanctions. The legal framework should cover the rules of commercial reasonableness, rules for notification of debtors, specification of rights of redemption, and conditions under which the secured party may undertake strict foreclosure (seizing and keeping the collateral).

safeguard consumer protection principles and public policy issues on homestead and exempt property in Vanuatu.

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

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Asian Development Bank (ADB) and Government of Australia Financing<sup>a</sup></b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	530,000	0	530,000
ii. Domestic Consultants	0	55,000	55,000
b. International and Local Travel	95,000	5,000	100,000
c. Reports and Communications	7,000	0	7,000
2. Equipment (software)	40,000	0	40,000
3. Training and Seminars	0	10,000	10,000
4. Contingencies	53,000	5,000	58,000
<b>Subtotal (A)</b>	<b>725,000</b>	<b>75,000</b>	<b>800,000</b>
<b>B. Government Financing</b>			
1. Office Accommodation and Transport	0	50,000	50,000
2. Remuneration and Per Diem of Counterpart Staff and Legal Services	0	100,000	100,000
3. Local Workshops and Seminars	0	25,000	25,000
4. Communications	0	5,000	5,000
5. Contingencies	0	20,000	20,000
<b>Subtotal (B)</b>	<b>0</b>	<b>200,000</b>	<b>200,000</b>
<b>Total</b>	<b>725,000</b>	<b>275,000</b>	<b>1,000,000</b>

<sup>a</sup> \$600,000 financed from ADB's technical assistance funding program, and \$200,000 from the Government of Australia, to be administered by ADB.  
Source: ADB estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. An international consulting firm will be engaged by the Asian Development Bank (ADB) in accordance with its *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB for engaging domestic consultants. The consultant team will comprise an international secured transactions expert (7 person-months), an international private sector development expert (4 person-months), one or more international legal experts as appropriate (7 person-months), an international technical registry-filing archive expert (6 person-months), and local lawyers (7 person-months). The international consulting firm is expected to be flexible in providing specialized legal expertise, as appropriate. The outline Terms of Reference (TOR) for each consultant is described as follows.

### **A. International Secured Transactions Expert–Team Leader (7 person-months)**

2. The secured transactions expert must have extensive international experience in the economic and legal analyses of secured transactions systems. Specifically, the expert will have developing country experience with problems in the framework for secured transactions and how they relate to access to credit; in preparing draft laws on secured transactions; in preparing administrative and technical regulations for notice-filing systems; extensive experience in research, legal reform, and registry projects; experience with both civil code and common law systems; and a good understanding of relevant computer systems required for establishing and operating a secured transactions filing archive. Prior experience in the Pacific islands will be an advantage. The expert will have a degree (at least masters or equivalent, preferably PhD) in law, economics, or a related area.

3. The expert will be primarily responsible for analyzing the economic role of collateral in the overall financial problems facing the economy. He or she will advise on the microeconomic aspects of legal drafting and ensure that the draft law and the filing archive have the desired effect on the use of collateral in financial and commercial transactions. The expert will undertake the following tasks:

- (i) Analyze the requirements for the law and its economic impact. Examples of such analysis include, but will not be limited to (a) the impact of changes in the notification periods for repossession; (b) evaluating whether the law should void contract clauses that require the consent of first priority lenders, permit parties to limit their claims in accounts receivable financing, limit possessory security interest to reduce the risk of fraud, or require free public access to the filing archive; (c) assessing whether the filing archive budget should raise fees only sufficient to cover its costs or whether it should also generate revenue for the supervising agency; and (d) evaluating whether banks should be given highest priority in their right to set off against nonbank lenders. The results of the analysis would appear in drafting choices in the law, annotations to the law, and in short notes and descriptions as appropriate.
- (ii) Coordinate the activities of all other staff members to ensure achieving the economic objectives of the Technical Assistance (TA) and prepare a work plan that sets out the activities of the TOR. The work plan will include details on the activities, including the estimated timetable for each activity, and its link to preceding activities.
- (iii) To measure the performance of the TA intervention, review the performance indicators and targets in the TA logical framework, and collect relevant baseline

data. After the filing archive and the law are operational, consultants reports will contain information such as (a) number of filings, sorted by type of collateral, type of borrower, type of lender, and regional location; (b) amount of credit outstanding; (c) discussion of what can be inferred from preceding data for access to credit, by volume of credit and distribution; and (d) survey of credit sellers and financial institutions to assess system performance highlights and shortfalls.

- (iv) Work with the international legal experts on a preliminary analysis of the economic consequences of relevant Vanuatu law, guiding the work of the private sector development (PSD) expert.
- (v) Take responsibility for the overall quality of drafting. Take primary responsibility for the parts of reports and laws that analyze the economic consequences of elements of the law and, with the PSD expert, link economic problems to their legal roots.
- (vi) Provide extensive training for local government officials, legal and banking practitioners, as well as project steering committee members, in implementing and applying the secured transactions framework.
- (vii) Make public presentations on the economic consequences of the reform.
- (viii) Coordinate responses to inquiries and questions by stakeholders and the public. Confirm that answers to questions explain, as appropriate, how the economic objectives of the law affect drafting choices.
- (ix) Chair discussions of the reports and draft law with stakeholders in Vanuatu to have the widest possible debate and support for the reform.
- (x) In support of efforts to measure development impacts of this TA, identify adequate performance indicators supporting the goal and purpose of this TA in line with international best practice; establish the baseline data for performance indicators and establish target performance milestones, as appropriate.

#### **B. International Private Sector Development Expert (4 person-months)**

4. The PSD 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 analysis of enabling conditions for private sector development and growth; institutional foundations of financial markets; finance for micro, small, and medium-size business development; and property rights and their impact on economic development. The PSD expert will have managerial experience in research, legal reform, and registry projects. Prior experience in the Pacific islands will be highly desirable.

5. The PSD expert will undertake the following tasks:

- (i) Take primary responsibility for a thorough analysis of the problems facing the private sector, based on ADB's existing private sector assessment (which should be updated in the relevant areas). Work with the secured transactions expert to analyze the role of problems in the secured transactions framework in explaining these private sector problems.
- (ii) Analyze the impact of secured transactions reform on financial market development in the economy, including lending by nonbank intermediaries.
- (iii) Recommend ways in which secured transactions reform can assist in developing rural areas and microenterprises, including the use of securitization to enhance the liquidity of microcredit institutions.

- (iv) Advise on the links between the secured transactions reform and the impact on various sectors of the economy. The PSD expert will analyze those sectors expected to benefit most from secured transactions reform, and the impediments that prevent other sectors from taking full advantage of secured transactions reform.
- (v) Assist the secured transactions expert in analyzing the economic impact of legal reform, both overall and in drafting choices, on their ultimate targets in the private sector. Together with the secured transactions expert, devise reform performance indicators, including baseline data. Close cooperation between the secured transactions expert and the PSD expert will ensure that the final product will achieve the aims of the project and extend access to credit through the use of collateral.
- (vi) Assist the secured transactions expert in providing extensive training for local government officials, and legal and banking practitioners in implementing and applying the secured transactions framework.
- (vii) Make public presentations concerning the potential economic impact of the law on different sectors, including preparing short notes that illustrate how the reform will benefit specific sectors of the economy.

### **C. International Legal Expert (7 person-months)**

6. The international legal expert will be an attorney with a law degree (preferably Master of Laws, PhD in Law, or equivalent). The expert should be licensed to practice law in at least one Civil Code or one Common Law jurisdiction or both, have extensive experience in drafting reports on how problems in the secured transactions framework limit access to credit in developing countries as evidenced by publications in legal journals; experience in preparing draft laws on secured transactions and draft administrative and technical regulations for notice filing 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 substitute legal expertise for specialized areas, as required and in agreement with ADB.

7. The international legal expert will undertake the following tasks:

- (i) Make a preliminary review of the relevant laws of Vanuatu at the outset of the project, and give a preliminary indication of where problems might be expected.
- (ii) Collaborate with the secured transactions expert to devise legal drafting approaches to the problems identified by the 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 them to the constraints in Vanuatu.
- (iii) Draft sections of reports dealing with the legal findings of the project.
- (iv) Draft all laws, in conjunction with the local lawyers.
- (v) Provide extensive training for local government officials, and legal and banking practitioners in drafting, implementing and applying the legal and regulatory secured transactions framework.
- (vi) Make presentations on international approaches relevant to Vanuatu's situation.

**D. International Technical Filing Archive Expert (6 person-months)**

8. The expert will have a relevant degree in computer science, or 5 years or more experience in Internet-based databases; expertise in SQL server, MySQL, Oracle, or equivalent databases; knowledge of ASP or XML and experience in linking databases to on-line input systems; and experience in setting up public registries or Internet-based notice filing systems for security interests, as appropriate.

9. The expert will undertake the following tasks:

- (i) Advise the secured transactions expert on all points of linkage between the law and technical options for the filing archive, including which legal drafting options present technical problems and which technical options require changes in the law.
- (ii) Assess the existing state of information technology (IT) in Vanuatu's registries related to secured transactions.
- (iii) Write the program for the online archive, including adapting existing work and linking it to Vanuatu systems, according to international best practice and taking into consideration aspects of data integrity, confidentiality, and security.
- (iv) Set up the model notice filing system at the outset of the project.
- (v) Recommend an appropriate design for IT security backup systems on-site and off-site.
- (vi) Maintain all draft reports and laws on a web page accessible to the public and for receiving questions concerning the reform and posting the answers. Maintain these question and answer pages throughout the project.
- (vii) Train counterpart staff to maintain the database and systems.

**E. Local Lawyers (7 person-months)**

10. The local lawyers will have a law degree and be licensed to practice law in Vanuatu. They will have experience in commercial and civil practice and in debt collection. This is a senior position requiring at least 10 years experience. Because of the need to get different perspectives on these issues from local legal experts, the international consulting firm should be prepared to clear at least two additional curriculum vitae with ADB to ensure the necessary depth.

11. The local lawyers will undertake the following tasks:

- (i) Provide the international consultants with the local perspective on problems and options for solution in the Vanuatu legal framework.
- (ii) Work with the secured transactions and PSD experts in liaison with local companies and private sector institutions (e.g., chamber of commerce) that would be able to identify economic problems arising from the problems in Vanuatu's secured transactions framework.
- (iii) Work with the international legal expert in identifying elements in all Vanuatu laws relevant to the draft law of secured transactions.
- (iv) Work with the international legal expert on the draft law for secured transactions.
- (v) Master relevant legal and economic issues to become an effective trainer, presenter, and promoter of the issues in Vanuatu.