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A single framework governing secured transactions?

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Context of the presentation

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- Observations inspired by experience in reform projects led in countries with different starting points, legal traditions and economic objectives
- Contrast with debates in advanced economies and the ‘common thinking’ in reform-promoting organisations (‘gospel’)
- Conclusions (not very conclusive)

What is meant by ‘single framework’?

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- → One ‘security instrument’ that can pledge different type of assets
- → One security instrument that can pledge all, present and future assets
- → A set of rules governing instruments that serve the same economic function (such as mortgage and pledge)
- → Functional approach: ‘embracing under one legislative roof all forms of security and related devices that serve the common purpose of facilitating the recovery of debts from a disposal of personal property’ (Michael Bridge)

Why a single framework ?

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- *Simplicity and efficiency*: one regime to use in all circumstances; avoid idiosyncrasies
- *Flexibility and power*: one stroke to control all collateral
- *Harmonisation within the jurisdiction*: no loophole and fairness of treatment
- *Harmonisation between different jurisdictions*: familiarity of instruments and cross-border recognition

Simplicity and efficiency

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- Jurisdictions where possessory pledge has been the tenet of secured lending – any exception to the need of dispossession treated with cautious
- Specific laws adopted to meet a particular demand of the market (e.g. Italy): target single type of assets, sometime for specifically defined debt (e.g. financing by banks of the asset)
- Lack of coherence of the system: difficult to operate for market participants; rules stretched to the limits, creating uncertainty (e.g. Morocco)

➢ What would a ‘single framework’ look like?

➢ What would be the limits?

Flexibility and power

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- Principle of specificity – tenet of Roman law: the assets given as security must be specified at the conclusion of the security agreement for a right in rem to be created
- Limiting for the creditors (future assets) and for the debtor (would want to use and dispose of the assets in the ordinary course of business)
- 'Floating charge' – recognised by English courts at end of 19th century: a security interest over a pool of changing assets of a company, which 'floats' until the point at which it is converted into a *fixed charge* and attaches to specific assets of the company ("crystallisation")
  - Right in rem? Very powerful for the creditor
  - Need for specific rules to cater for specific markets?

Harmonisation within the jurisdiction

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- Federal state: objective is to unify all states' laws (e.g. Uniform Commercial Code)
- Secured transactions – historically an area with numerous legal acts overlapping and creating loopholes and complications for parties (e.g. Australia) - need to be rationalised
- Functional approach: uniform rules of priority which ensure fairness among creditors; uniform rules of enforcement

- ➢ Recharacterisation of the transactions – not as parties intended
  - ➢ Borderline cases can be tricky – e.g. financial lease

Harmonisation between different jurisdictions

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2001 Cape Town Convention on International Interests in Mobile Equipment

- International protection of security and leasing interests (including conditional sale agreement and leasing agreements)
- Validity and enforceability of the interest, including when equipment moves to another jurisdiction; registration in the International Registry

2002 EU Directive on Financial Collateral

- Set of substantive, mostly permissive rules applying to all EU Member States
- Objective to recognise the arrangements entered into by the parties, regardless of whether these arrangements are made in the form of a title transfer or a pledge over the collateral
- Formalities eliminated (i.e. no registration of the pledge should be required)

  - ➢ Does it make sense outside the cross-border context?

Experience in EBRD region of operations

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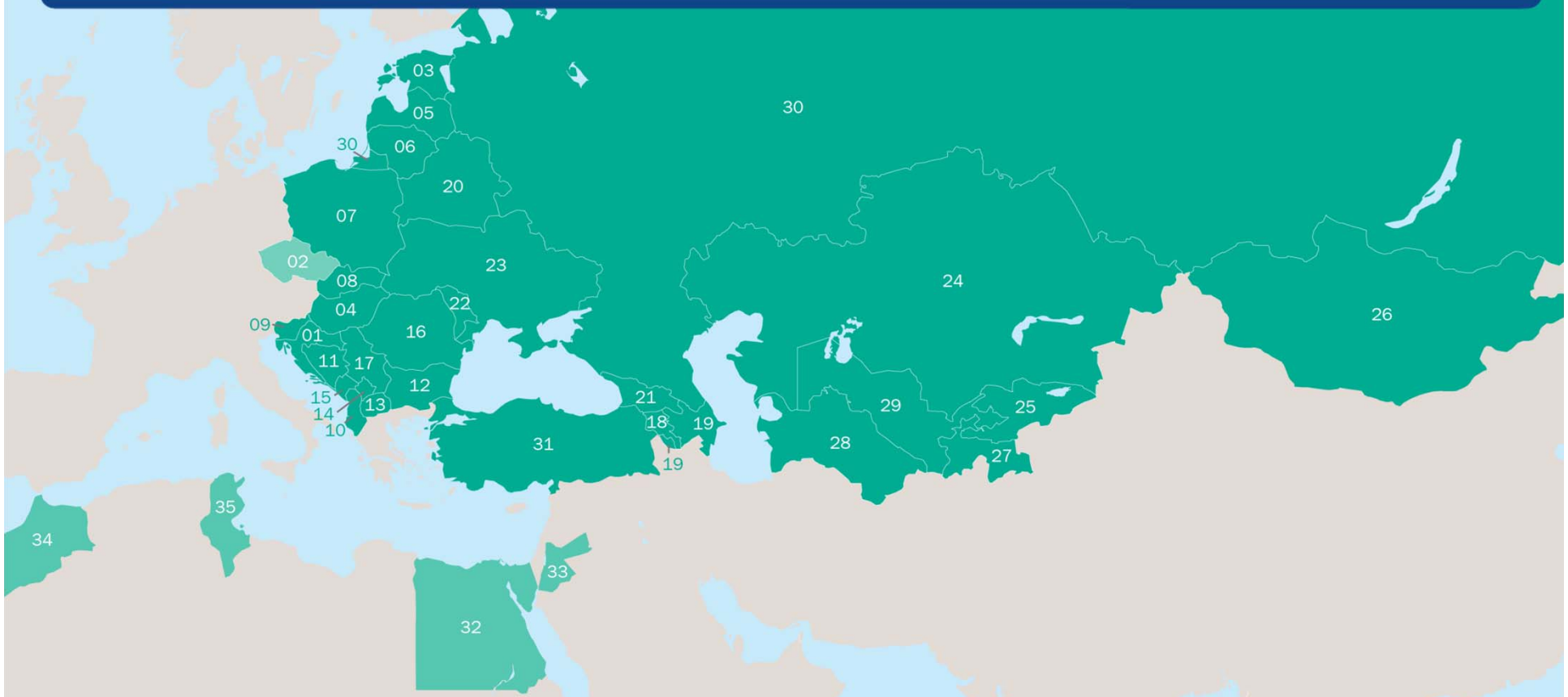

POTENTIAL COUNTRIES OF OPERATIONS

Southern and eastern Mediterranean

32 Egypt
33 Jordan
34 Morocco
35 Tunisia

In 2011 the EBRD launched donor-funded activities in the southern and eastern Mediterranean (SEMED) region, in support of the countries which are undergoing important political and economic reforms.

EBRD COUNTRIES OF OPERATIONS

Central Europe and the Baltic states

01 Croatia
02 Czech Republic*
03 Estonia
04 Hungary
05 Latvia
06 Lithuania
07 Poland
08 Slovak Republic
09 Slovenia

South-eastern Europe

10 Albania
11 Bosnia and Herzegovina
12 Bulgaria
13 FYR Macedonia
14 Kosovo
15 Montenegro
16 Romania
17 Serbia

Eastern Europe and the Caucasus

18 Armenia
19 Azerbaijan
20 Belarus
21 Georgia
22 Moldova
23 Ukraine

Central Asia

24 Kazakhstan
25 Kyrgyz Republic
26 Mongolia
27 Tajikistan
28 Turkmenistan
29 Uzbekistan

30 Russia
31 Turkey

*as of the end of 2007, the EBRD no longer makes investments in the Czech Republic.

Experience in EBRD region (continued)

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- Countries starting from low base – very little legal mechanisms for taking security, limited practice and weak institutions: e.g. **Mongolia** → priority of consistency between the rules
- Countries that reformed heavily in the 90s – in sometimes uncoordinated fashion: e.g. **Poland** → enterprise pledge; mortgage law made more flexible
- Countries well advanced to fully-fledged market economies and in need of developing specialised markets for secured lending: e.g. **Serbia** → warehouse receipts law; crop receipts draft law

Experience in EBRD region (continued)

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- Countries that have security legal mechanisms embedded in an not security-friendly approach: e.g. **Morocco** → how far does the country want to go?
- Countries which seized the opportunity of reform to provide some coherence among various instruments serving as security: e.g. **Romania** → wide registration
- Countries where it is hard to read the direction: e.g. **Russia** → all of the above?!

EBRD approach: legal efficiency criteria

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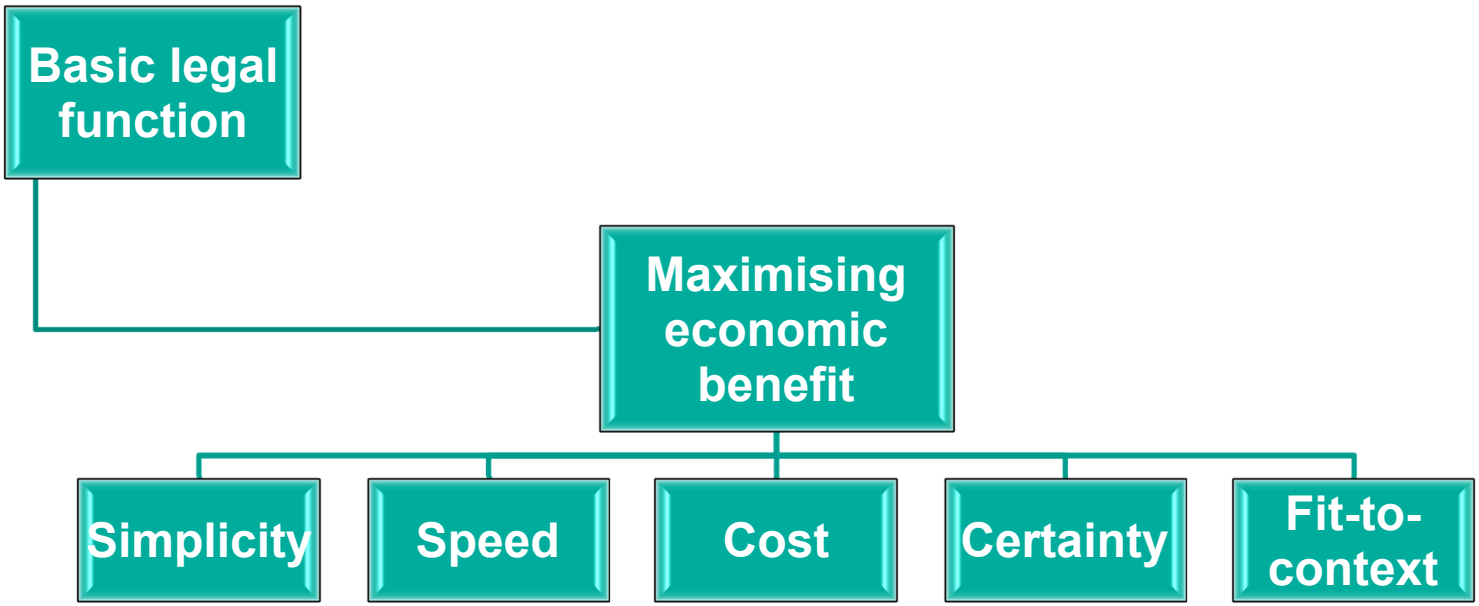
Purpose of security law is economic : reduce credit risk
Legal framework is facilitative



Conclusion

- It depends…
- Rigid or too orthodox approach probably not realistic in medium term
- Question: what is the opportunity? and what could be the loss?
- Dialogue between lawyers, economists, bankers and policy-makers