

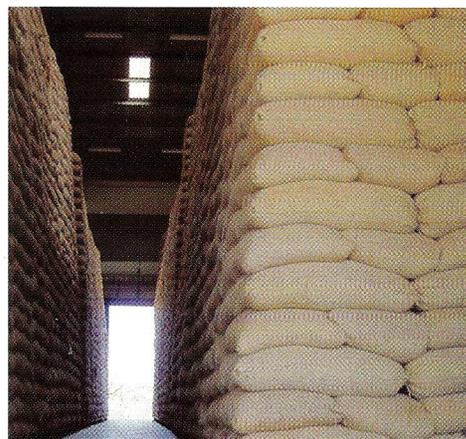


**USAID**  
FROM THE AMERICAN PEOPLE



**FEED THE FUTURE**

The U.S. Government's Global Hunger & Food Security Initiative



June 2015 Policy Brief No. 2

## **SERA Policy Brief**

### *A Secured Transactions/Collateral Registry System Can Unlock Credit to Smallholders and SMEs \**

Access to finance improves when financial institutions have the ability to secure loans with collateral so that their risk is limited in case of default. The two most common forms of collateral are land and moveable property. Land is often difficult to use as collateral in Tanzania because of the lack of title and the difficulty of changing land ownership. Moveable property is also difficult to use as collateral because existing laws do not provide the legal protection necessary to encourage lending for various types of moveable property. The solution is a simpler legal and regulatory structure for collateralized lending. Such a system is called a Secured Transactions System based on a Collateral Registry. In Tanzania, it would be achieved by enacting a new Personal Property Security Act (PPSA) and Regulations for a new Collateral Registry.

Reforming Tanzania's Secured Transactions laws would help alleviate poverty by improving access to credit in the agricultural sector and for small- and medium-scale enterprises (SMEs), precisely the economic players who have typically not had access to credit. Movable assets include growing and harvested crops, agricultural goods in warehouses or other storage, livestock, inventory, equipment, accounts receivable, bank deposits, securities, intellectual property rights, rents, contractual rights, and other moveable assets limited only by the creativity of the commercial sector in finding ways to create sources of economic value. Thus, if a country's legal system can provide a means of utilizing movable assets to guaranty credit, it frees the financial and credit sectors to reach their full potential. As the risk of non-payment goes down, so should the interest rate charged for credit and credit should become available to many borrowers who currently do not have credit. This supports growth and development at all levels of society, but particularly at the levels and in the sectors currently denied access to credit. A proper Secured Transactions system is a powerful tool against poverty.

\* Based on research by the SERA Policy Project of the USAID Feed the Future Initiative and Dale Furnish, emeritus professor of law at Arizona State University. Additional details can be obtained by contacting Marialyce Mutchler, Chief of Party of the SERA Policy Project at [Marialyce.Mutchler@tzsera.com](mailto:Marialyce.Mutchler@tzsera.com) or Dale Furnish at [Dale.Furnish@asu.edu](mailto:Dale.Furnish@asu.edu).  
The SERA Policy Project is a USAID funded project that seeks to improve agricultural policies and develop capacity for policy.  
The project is implemented by Booz Allen Hamilton.

A properly functioning Secured Transactions System depends on a single electronic registry in which all security interests created under the law must be registered to fix a given lender's date of priority against specified collateral and enable enforceability in case of default. Some personal property used as collateral—cash, bank deposits and accounts, negotiable warehouse receipts—could fall outside the registry but not outside the system. Any new PPSA would contemplate such items of collateral and provide for them in the same system with the same sort of clear priority. Usually this is done by requiring possession or control of the special types of moveable collateral for which negotiability forms part of their nature. A single electronic registry, however, forms the heart of the system, which cannot function without a universal registry. Such registries exist in neighboring African countries and other developing countries in Latin America. The software is available, and a modern registry can be set up relatively quickly and for relatively little cost. The Collateral Registry could function through the internet or cellular phones. Cell phones are everywhere in Tanzania, and would permit lenders to register their security interests and review existing security interests for any potential debtor by simple cell-phone access. This would create a functioning nationwide registry system, available 24 hours a day, 7 days a week from anywhere in Tanzania. The SERA Project is supporting the Bank of Tanzania to develop and implement a Secured Transaction System and Collateral Registry and the World Bank will provide financial support to the activity.

## **A Legal System Grown Awry**

While real property takes one form in the eyes of the law (land and improvements permanently attached to it), personal property takes multiple forms; e.g., automobiles, farm equipment, machinery in factories, inventory, bank accounts, accounts receivable or invoices, intellectual property such as patents and trademarks, growing crops, warehoused grains and other foodstuffs, warehoused hard goods, livestock, cargo in transit, mine ore and cut timber. Over time, these various forms of personal property were dealt with by setting up different laws, to deal with each one separately. Thus, while real estate security typically takes the form of a mortgage, for personal property security the law has provided a crazy quilt of statutes including among others the Bill of Sale Act, the Chattels Transfer Act, the Contracts Act, the Hire Purchase Act, the Companies Act, the Incorporated Private Partnership Act and the Finance Lease Act, establishing less a system than a collection of disparate mechanisms all of which take different routes to the same goal—giving a creditor the right to claim debtor's assets on default. Different registries exist for different acts and some charges need not be registered at all.

The lack of a system means lack of priority when two or more creditors compete for the same collateral. The uncertainty in priority, or even the validity of the security interest, increases the creditor's risk. Before a creditor can make a loan to a prospective borrower offering personal property as collateral, the creditor must check several registries or other sources to confirm whether it can take a first priority in the personal property the borrower offers, and even then often the creditor cannot be certain. In such circumstances, the price of credit comes high, reflecting the risk to the lender. Often, lenders simply offer no credit at all to whole classes of prospective borrowers, because they can offer no certain collateral and risk makes unsecured loans a bad deal.

This describes the situation in Tanzania today, with millions of smallholders and other prospective borrowers effectively excluded from the credit market for lack of viable collateral with which to secure their loans. Typically, interest rates on secured loans run 18% or higher, so even where Tanzanian borrowers can get secured credit, they may have to pay ten or twenty percent more in interest and costs than borrowers in countries with new laws for personal property security. The new laws have come about because the legal mess in personal property security attracted attention, and encouraged reforms that have remedied the problem by unifying all forms of personal property security in a single all-inclusive system, with a single all-inclusive registry.

## Country after Country Has Adopted a New Kind of Law

The reform of personal property security laws began in the United States (1952), followed by Canada (1967). New Zealand (2006) and Australia (2010) have passed new laws more recently. Steadily, country after country has created new personal property security laws, also known as Secured Transactions Laws or Personal Property Security Acts. In Africa, Liberia (2010), Ghana (2011) and Malawi (2013) have new laws, while Mozambique is actively considering following suit. In Latin America, Peru (2004), Guatemala (2008), Mexico (2010), Honduras (2011), and Colombia (2013) have new laws while Chile, Argentina, Costa Rica and El Salvador have similar new laws under active consideration. In Eastern Europe, Albania, Kosovo, and Georgia have new laws, while several countries are considering reform. In Asia, China has passed new legislation.

Many of the new laws are patterned after model laws developed by the United Nations' Commission on International Trade Law (UNICTRAL, Legislative Guide 2007), the World Bank's International Finance Corporation (IFC Toolkit 2010), the European Bank for Reconstruction and Development (EBRD), or the Organization of American States (OAS, Model Law 2002) which are focused on efforts to reform commercial laws on credit guaranties against moveable property. In the last quarter century, lawyers, scholars and policy makers have recognized the enormous effect that these laws have on access to credit for the smallholders that form the bulk of the world's population. Policy makers and planners have begun reforming outdated systems that in many ways date back to Roman times with the goal of using the law to achieve maximum social and economic benefits.

What drives the reform is that much of the world's wealth is becoming concentrated in moveable property (growing and stored crops, livestock, automobiles, equipment, accounts receivable, inventory, bank accounts, intellectual property). While real estate maintains its place as a high source of value and continues to serve as an important credit guaranty, moveable property has long surpassed it in aggregate value. Until recently, laws have not fully recognized that fact, making credit guaranties against moveable property costly or virtually useless, increasing the risk to lenders and the price to borrowers. Reducing the lenders' risk by changing the law can make more credit available to many more borrowers at much lower interest rates, creating more jobs and increased production in all sectors of the economy, and thereby helping to reduce poverty.

### A Central Concept...

The new laws have a common core. All of the laws focus on unifying systems of diverse laws developed over centuries into a single system operating on a unitary concept—the "security interest"—that encompasses all forms of guaranty against personal property as collateral for credit. The crazy quilt of chattel mortgages, finance leases, hire purchase, floating debentures, retention of title and more all now become a single mechanism in the eyes of the law: a security interest. An essential part of the reform turns on creating a single registry, charging a nominal fee for each registration, in which all such guaranties must register or have no effect against third parties who might claim the same collateral.

### **...that Requires Changes in Established Legal Practices** ~ **Registration to fix priority by notification rather than validation**

The new laws' application of the central concept of a unitary security interest means that deeply ingrained practices must change. First and foremost, the new system turns on the proposition that personal property security

agreements themselves—unlike real property security agreements—do not have to be registered to be valid and to fix a date of priority against third party claimants to the same collateral. Rather, the system sets a given creditor's priority from the date it registers a summary notice that the creditor might have a security interest in certain of a given debtor's collateral. This simple notion often provokes violent reactions within the legal community. It conflicts directly with the law's long-standing article of faith that the document itself, as signed by the parties, must be registered to validate the claim.

The change to notice registration of security interests means that a single filing may continue a fixed priority for five years (the usual term) renewable, and support a series of secured loans, or a continuing line of credit, against the same collateral. Only when a creditor wishes to enforce the security interest upon debtor's default does it have to come forward with documents to prove its security interest, while standing on the registration to fix the date of its priority. Commonly, the security agreement that the creditor wishes to enforce will not have existed at the time of the registration and date of priority.

Registries for the documents that create security agreements—however they may be styled—may still exist for the purpose of validating those documents on the public record, but they do not set the date of priority for those security agreements against third parties. According to the law, only the unique registry for security interests can do that.

### ***~ Enforcement of security interests by extra-judicial action of the creditor***

The other aspect of the new personal property security laws that often causes strong reactions within the legal community is the idea that in the event of a debtor's default creditors may take direct action against their collateral and claim it from the debtor without going through a court and getting a judicial order. At first, lawyers usually view this "self-help" approach to collections as a violation of due process, perhaps the most fundamental of constitutional rights. In fact, the possibility that the creditor might proceed directly against the debtor upon default reduces the costs and delays of enforcing the security interest. Overall, self-help enforcement can further lower the price of credit. The new laws require that the creditor must act with debtor's cooperation, so that if a debtor wishes to resist—that is, assert its right to due process—and force the creditor to go to court, debtor can. Most often, however, experience has proved in those countries that permit extra-judicial enforcement that creditors exercise the right responsibly, and debtors often admit their default and cooperate in turning over collateral.

### ***Tapping the Power of Moveable Property to Guaranty Credit***

Smallholder farmers and small businesses have always found it difficult to obtain credit at reasonable rates. That could change if a new Personal Property Security Act and Collateral Registry were implemented in Tanzania. The new act would unify existing systems of charges under diverse laws into a single system and make it easier to use moveable property for collateral. The registry would fix the priority of lenders to collateral used to secure loans. Farmers could use assets such as crops growing in their fields or stored in a warehouse for collateral. Small businesses could put up their existing assets as collateral to grow by adding new assets. Lenders would have lower risk and farmers and small businesses could get loans at lower interest rates. Urban populations would also benefit, since they include a majority of smallholders engaged in business and commerce. Access to credit at reasonable interest rates could support more economic activity, increase employment and reduce poverty. Other countries have this law; Tanzania needs it, too.