
“No Comfort”

Foreclosure and Debt Recovery Laws and Procedures in Pakistan



by the
Pakistan Shelter Resource Mobilization Program
Office of Private Enterprise and Energy
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Foreword

Over the past five years, Pakistan has been moving toward a more liberal, less-regulated finance system, one that relies far more on market forces to allocate credit and establish rates of mark-up. This movement has created a number of opportunities for new types of financial firms to establish themselves. As directed credit is reduced and subsidies become more constricted, there is an increasing need to develop financial intermediaries to channel market-rate funds into a number of sectors that urgently need to be integrated into the financial system.

No sector offers greater potential in terms of economic scope than does housing finance. Housing has long been neglected, and reliance solely on subsidized housing loans through House Building Finance Corporation has never begun to meet demand for loans. Enormous potential exists for specialized housing finance companies to enter the market for funding of new construction, home improvement, and mass housing development.

Over the past five years, the U.S. Agency for International Development, through its Shelter Resource Mobilization Program (SRMP), has assisted the Government to begin establishing a market-based housing finance system dominated by private housing lenders. A critical component of how well the new housing finance system can perform will be dictated by the legal environment in which the firms operate. Housing lending is typically based on credit against which real property is offered as collateral (mortgage).

A fundamental question facing the new housing finance lenders is whether the legal system will efficiently resolve legitimate claims when borrowers default on repayment. Without "comfort" from the law, little lending will occur. Similarly, the rights of borrowers must be respected, so that when they borrow, they feel confident the property they pledge can not be unjustly taken away. Without "comfort" from the law, little borrowing will occur. This question is made more critical in Pakistan, because foreclosure law is antiquated, property rights insecure, the legal system has a poor track record when faced with foreclosure cases, and public lenders have a history of managing defaults poorly.

On behalf of U.S.A.I.D., the SRMP is pleased to offer the following study of foreclosure and debt recovery in Pakistan. We hope that it will assist in the development of sound policies and mechanisms that lay a stable legal foundation for the development of housing finance.

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October, 1993*



Executive Summary

This report relies on research carried out by 21st Century Consultancy and Management Services of Karachi, Pakistan, under contract with the Shelter Resource Mobilization Program (SRMP) of the United States Agency for International Development Mission to Pakistan. Through the SRMP, the U.S. Agency for International Development, in conjunction with the Ministry of Finance, is helping Pakistan establish market-oriented housing finance. To achieve this goal, new private and joint-sector mortgage lenders need a supportive legal and policy environment that ensures financial integrity and facilitates growth.

The focus of this report is on the constraints imposed by Pakistan's laws and legal procedures in regard to recovery of debts, and the actions that should be taken to promote a legal and policy environment that supports the ability of the emerging market-oriented housing finance system to expand. The study is based on original field work, extensive interviews, and a review of available data and policy documentation.

The report introduction summarizes the fundamental requirements of a strong market-oriented housing finance system and the associated benefits to the overall economy. Regional examples demonstrate the linkages that exist between economic expansion, housing development, mortgage credit, and the legal and policy environment in which housing finance institutions operate.

The second section of this report reviews the status of housing finance in Pakistan and

outlines the current legal framework for debt recovery. Foreclosure and debt recovery cases in Pakistan frequently take 10 years or more to resolve. Delays are characterized by overworked and understaffed courts, the courts' reluctance or inability to comply with statutory time limits, inadequate office management methods and equipment used by court registries, liberal granting of appeals, frequent adjournments without punitive costs, and alleged collusion on the part of court officials, banking officials, defendants, and counsel.

Antiquated systems of land titling and transfer, coupled with exorbitant stamp duties, have complicated both the lending and recovery process and are a primary deterrent to the future growth of housing finance in Pakistan.

The third section of this report summarizes the results of field studies in Malaysia, India, and Sri Lanka conducted by Askari Taqvi, Consultant, 21st Century C & MS, and



William Strong, Housing Finance Advisor, SRMP. The findings from these studies demonstrate the linkages between finance policy, the legal environment, and the relative success of developing housing finance systems in the region.

In Malaysia, for example, recent economic expansion has been accompanied by an explosive growth in housing construction and mortgage credit. Management of HFC's is efficient and effective; land titling, registration, and transfer systems are sound, although stamp duties are still high; and a strong legislative and regulatory framework facilitates growth of the housing sector, allowing public and private sector lenders to foreclose relatively quickly on defaulted loans in the lower courts.

Although the High Court in Malaysia has been experiencing significant delays in bringing cases to trial, efforts are being made to amend existing legislation to improve the situation. However, housing finance institutions in Malaysia have also recognized that the ability to recover outstanding debt through the legal system is only one component of a successful housing finance system. Information from credit bureaus, rating agencies, and trade associations is increasingly being used as a preventative management technique that enables institutions in Malaysia to make informed decisions about an applicant's credit record at the evaluation stage of the loan application.

In India, the laws and procedures that govern debt recovery and foreclosure are highly similar to those of Pakistan, and a suit for enforcement of mortgage can take well over 10 years. Land titling, registration, and transfer procedures are cumbersome and a large number of transactions are illegally performed to avoid high titling charges and taxes.

Yet, there is a growing private and joint-sector housing finance industry in India, supported by an active public sector National Housing Bank that assists private and joint-sector firms to mobilize resources. India's housing finance firms have developed an enviable capability for good administration, and demonstrate that when the legal environment is inadequate,

lenders need to manage their businesses in an exemplary manner. Nonetheless, the growth of housing finance in India is still constrained by the legal environment. In an effort to improve the situation, a bill was recently introduced in Parliament to establish Banking Tribunals similar to those in Pakistan to expedite debt recovery cases.

In Sri Lanka, resources for housing remain limited because economic growth has been slow and unsteady and because resource mobilization for housing is largely in the public sector. However, foreclosure is relatively straightforward, and when a default occurs, a lender can recover the property and sell it, usually within six months and often without recourse to the courts.

Recent legislative amendments have been enacted in Sri Lanka to further improve the legal environment for lenders, and special "Commercial Courts" have been proposed to deal exclusively with debt recovery and a variety of commercial cases. Although Sri Lanka has multiple land registration systems in operation, land titling has not posed any significant problems because financial institutions commonly use lawyers to perform title searches before authorizing loans. In addition, all property evaluators in Sri Lanka must be licensed. These activities have provided housing finance institutions with improved indicators of value and a certified title to mortgaged property, thereby reducing lending risks.

Based on the results of the research conducted for the SRMP in Pakistan, Malaysia, India, and Sri Lanka, the fourth section of this report discusses recommendations for improvement to the legal environment for debt recovery in Pakistan.

A draft of this report was distributed at a national seminar on Foreclosure and Debt Recovery Laws and Procedures held in Karachi, Pakistan on May 9, 1993. This one-day seminar was sponsored by the U.S.A.I.D. SRMP in conjunction with 21st Century Consultancy and Management Services, and was developed to promote agreement among policy makers on actions



required to improve the legal environment for mortgage lenders. Participants representing the legal, government and financial sectors, including housing finance companies and commercial banks, attended.

At the close of the seminar, a drafting committee was formed to finalize the seminar conclusions and recommendations, which are discussed in the final section of this report, and are summarized below:

Improve Judicial Determination: A major conclusion of the seminar was that the law governing debt recovery in Pakistan is adequate. However, a primary obstacle to the recovery of debts are chronic delays in court procedures. Judicial determination toward the implementation of debt recovery law must become meaningful and purpose-oriented, and the existing provisions of the law must be strictly applied by judges and functionaries in order for justice to be served.

Improve Enforcement of Decrees: Execution of decrees are a significant problem, and amendments in the law to simplify procedures for execution, in particular to enable the decree-holder to obtain vacant possession of the property, should be considered. Tribunals should be provided with mechanisms for enforcement instead of having to rely on the district administration and the police. A possible solution would permit private agencies that are regulated by a licensing system to implement decrees. To minimize potential fraud and/or collusion, payment would be contingent upon successful execution of the decree.

Allocate Increased Resources to the Courts: The number and geographical spread of Banking Tribunals needs to be increased. In addition, the courts often do not have the basic office equipment and support staff required to perform their work in a timely fashion. To finance improvements to the Banking Tribunal infrastructure, a user fee representing a small percentage of the claim filed by lending institutions should be considered as a commercially viable means of funding the necessary material resources required.

Improve Land Titling: A sound land titling system is fundamental to the growth of housing finance in Pakistan. Currently, uncertainty in land titling and registration makes it difficult for financial institutions to lend in the housing sector. A comprehensive study should be conducted under the authority of the Federal Government with the goal to develop one functional land transfer and registration system for the entire country.

Reduce Stamp Duties and Registration fees: The lack of compulsory registration of title documents, high fees levied under the Registration Act, and the exorbitant rate of stamp duties are primary factors that discourage the proper recording of land transactions. Clearly, if rates were reduced, more people would register property transactions. Revenue would be optimized while the current hindrances to financial and economic activity, particularly in the housing sector, would be significantly reduced. This is a provincial government issue; however, it requires the Federal Government to assume the initiative for change and to coordinate action with the provincial governments for a consistent fee structure in the country.

License Property Evaluators: Housing Finance Institutions should work with the Institute of Chartered Surveyor's to develop a comprehensive system of licensing and regulation of property evaluators.

Limit Adjournments: Adjournments should be strictly limited in accordance with the law and punitive costs should be enforced.

Criminalize Bad Checks: Criminal penalties for issuing bank drafts on insufficient funds would be an effective tool for pursuing loan defaulters in cases where "bad" checks are involved. This legislation is currently under advanced stages of review by the Ministry of Finance, therefore no further action was proposed by the drafting committee.

Limit Court Intervention: Under Section 69 of The Transfer of Property Act, a banking company is allowed to sell property without intervention of the courts. Housing finance



companies should be considered banking companies for the purposes of this legislation.

Regulate Housing Developers: A regulatory framework for the development of housing should be implemented along the lines of that currently established in Malaysia. Developers are required to be licensed, and in turn, regulatory authorities monitor their performance and conduct. Developer accounts are managed by banks or HFCs and prevent potentially unscrupulous developers from misusing mortgage funds. Developers found guilty of offenses under the law are prosecuted.

Standardize Forms and Procedures:

Emerging HFCs should standardize all loan application and processing forms, and standard Sales and Purchase Agreements should be required to safeguard the interests of both home buyers and developers. Accounting and loan collection systems should be computerized.

Monitor the Courts: Banking Courts and Tribunals, like other courts in Pakistan, should be periodically inspected by the Superior Judiciary. In particular, cases that have not been processed within the timeframe established by law should be tracked and monitored closely for resolution.



Introduction

A new housing finance system is emerging in Pakistan, one likely to be dominated by private, market-oriented mortgage firms. Demand for housing credit is high, and the new system offers great promise to mobilize the resources needed to improve housing and stimulate the construction industry. Will these firms succeed? Does the legal environment support them? Resources will only flow into housing if investors have confidence that mortgage loans can be recovered.

In Pakistan, there presently are two conflicting financial sector trends: First, there is a trend to liberalize and deregulate the economy, and to increasingly rely on the private sector to meet people's credit needs, including mortgage credit. This is a positive development, but will ultimately fail if credit institutions can not rely on fully recovering loans.

Second, a strong "myth" has developed that borrowers do not repay loans. There is ample evidence — from the performance of public sector lenders — to suggest that the myth is true. In the case of housing finance, the poor record of House Building Finance Corporation (HBFC) suggests that many people feel little need to make repayments and feel virtually no fear that default will lead to foreclosure. This trend inhibits private investors and finance institutions from making credit available even to honest credit-worthy people.

In Pakistan, debt recovery procedures, including foreclosure, need improvement. Typically, foreclosure cases take 10 or more years to resolve, during which the lender loses money and the defaulting borrower generally

continues to be able to live in the property. Thousands of debt recovery and foreclosure cases have "piled up," bogged down in a swamp of delay and legal maneuver. Several billion Rupees worth of loans defaults are unresolved.

Foreclosure is a lender's "ultimate threat" and most persuasive encouragement to obtain loan repayments. Given the performance in regard to foreclosure cases, however, foreclosure is scarcely a threat at all. Rather, it appears that even in instances when borrowers' pleas have little merit, years of delay may occur before court or banking tribunal decrees are executed. Lenders have little choice but to re-schedule loan payments in the hope of eventual payment.

Studies carried out by the SRMP in Malaysia, India, and Sri Lanka show that improvement of financial sector performance is accompanied by improvements in the legal and policy environment. These improvements are essential to the full development of economic efficiency and critical to the development of housing finance. The improvements needed, however, are not simply legal changes, but in

Benefits of a strong market-oriented housing finance system...

- *more and better housing*
- *a stronger construction industry*
- *improved savings rate and greater investment in fixed capital*
- *credit flowing at market rates and according to demand*
- *a broader and deeper financial sector*



Two views...

Borrower:

“A man’s home is his castle.”

Lender:

“A man’s home is his castle, when it is paid for.”

effect are the creation of a new relationship between lenders and borrowers.

Culture, tradition and the law are the basis of this relationship. There is little in the culture of Pakistan that suggests that people do not take debt as a serious matter or that Pakistanis are inherently unwilling to repay loans. But, over the years, the tradition of performance by Pakistan’s public sector lenders has taught people a simple lesson: it is quite possible to borrow without having to repay. At the same time, the legal system has demonstrated that its machinery is incapable of dealing effectively with loan default cases.

Public sector lending institutions should not operate on this basis. Private sector lending institutions can not.

Credit is the “lifeblood” of economic expansion. In Pakistan, little credit is available to the ordinary man, who is generally forced to save the entire purchase price of any and all products. This is not entirely a bad situation, but it certainly constrains the ability of people to purchase products with larger “price tags,” especially housing.

In more developed economies, real property, including housing, provides security for much of the credit that is available. Virtually all housing, most automobiles, many appliances, and many other products are purchased “on time.” In particular, land and housing are very often the security for loans to start businesses.

Assuming funds are available for lending, two basic factors govern how much credit is available and who has access to it:

First, how credit-worthy is the borrower? Does the borrower have the income necessary to repay the loan? Is the value of the property or other product for which the loan is being borrowed equal to or greater than the loan? These are business judgements, and businesses that make poor judgements fail.

Second, if the borrower stops making payment, can the lender quickly recover the loan? Loans can be re-scheduled, but if the borrower defaults, what recourse does the lender have?

Can the lender take the property? This falls into the legal and policy environment. A system that gives lenders little or no “comfort” on this issue is a system in which loans must be based on “personal knowledge” of the borrower and his financial abilities. Such a system inherently constrains the expansion of credit, since relatively few potential customers for credit are “personally known” to finance institutions.

Essential requirements for a strong market-oriented housing finance system...

- ***confidence that defaulted loans can be recovered in a reasonable time period***
 - ***confidence that losses due to default can be recovered from the mortgaged property***
 - ***confidence in land titling and registration procedures***
-

Foreclosure is a sensitive issue, especially when an occupied house is involved. Both lenders and borrowers have legitimate rights. Individual homeowners are apt to view things from the perspective of “A man’s home is his castle.” Lenders may prefer to re-phrase that as “A man’s home is his castle *when* it is paid for.” To expand credit for housing in Pakistan, it is necessary that the law and its machinery strike a balance between the rights of the lender and the borrower. The balance that is developed must be acceptable to both.

Within the region, several examples exist that demonstrate the linkages between economic expansion, housing development, mortgage



credit, and the legal and policy environment in which housing finance institutions operate.

In Malaysia, the rapid economic expansion of the past few years has been accompanied by an explosive growth of housing construction and mortgage credit. It has also been accompanied by revised laws and procedures that facilitate growth and permit both private and public sector lenders to foreclose quickly (within two years, but generally faster) on a default. Less than 3% of borrowers default. The balance struck between lenders and borrowers in Malaysia has benefited both parties: people have become far better housed; lenders continue to be profitable and able to expand their business; the housing construction industry has provided many jobs for workers and opportunities for lenders.

In Pakistan, although the economy has grown steadily, there is a severe housing shortage, little mortgage credit is available, and the housing construction industry is fragmented and inefficient, contributing little to the economy. The repayment record of HBFC is poor and private finance institutions look at long-term lending for housing with great skepticism because debt recovery procedures are slow and tedious and foreclosure proceedings are circumscribed by procedures and legal techniques that create years of delay. Borrowers have great suspicion of lenders that want real property to secure loans, believing that the lenders want to seize their property. There is little if any balance between lenders and borrowers; both suffer as a result and the basis for expansion is limited.

The two examples above demonstrate the different results that occur when a growing economy either does or does not provide a legal environment that supports the growth of financial sector services.

However, although effective debt recovery and foreclosure measures play a role in the expansion of credit, they dictate neither success or failure. The following two examples demonstrate this.

In Sri Lanka, economic growth has been slower and unsteady. Housing finance is

growing slowly and remains dominated by public sector institutions. Resources for housing remain limited, both because economic progress is slow and because resource mobilization for housing is largely in the public sector. Yet, foreclosure is remarkably simple, and, when a default occurs, lenders can take the property and sell it within six months, often without recourse to the courts. The Sri Lankan example demonstrates that effective debt recovery systems and foreclosure laws do not automatically generate a strong flow of resources into housing credit; resources and effective institutions are also needed. However, when resources do become available, Sri Lanka's legal situation provides the basis for rapid expansion.

Examples from the region show that a country's housing finance system will be only as strong as the finance policy and legal environment in which it operates. Pakistan is lagging behind other countries of the region — housing finance in Pakistan is at a disadvantage in regard to:

- ***competing for resources***
 - ***equitable and timely debt recovery***
 - ***land registration practices***
 - ***support provided by national policy***
-

In India, economic progress has also been slow. The laws and procedures that govern debt recovery and foreclosure are highly



Housing Development Finance Corporation in India demonstrates that a housing finance company CAN be successful without effective foreclosure procedures.... but HDFC's strong management capacity and financial reputation took years to build.

similar to those of Pakistan. Yet, there is a growing private and joint-sector housing finance industry, supported by an active public sector National Housing Bank that assists the private and joint-sector firms to mobilize resources. India's housing finance firms have developed an enviable capability for good administration.

Led by Housing Development Finance Corporation (HDFC), they have mastered credit risk analysis, avoid risky borrowers, and quickly follow-up with late-paying borrowers. In its first 14 years of operation, HDFC has initiated foreclosure proceedings only 15 times. Last year, HDFC made thousands of new

loans, maintained a recovery rate in excess of 98%, and declared a dividend of 24%. The Indian example demonstrates that when the legal environment provides little "comfort," lenders need to avoid it by managing their businesses in an exemplary manner.

However, although the example demonstrates that "it can be done," only HDFC has established its reputation and is fully capable of mobilizing resources; other firms rely heavily on assistance from the National Housing Bank. In short, the inadequate legal environment in India still constrains the growth of housing finance.

The above examples from the region offer many lessons:

- Good administration is always desirable; when the legal environment fails to support business, excellent administration is imperative. In the case of Pakistan, however, housing finance is virtually unknown and experience at managing housing finance companies is extremely limited. Given this situation, private investors will remain reluctant to invest in housing finance, which will grow very slowly unless the "comfort level" of investors is raised.
- In other countries in the region, appropriate balances have been struck between the rights of lenders and the rights of borrowers. In Pakistan this does not appear to be the case, especially in regard to housing finance. This imbalance is epitomized by the relevant law and procedures, which greatly favor borrowers.
- Poor administration results in making "bad" loans and leads borrowers into default. When poor administration is the standard, not only will loan recovery be poor, but there is little reason why the legal system should be expected to support business to recover from its own poor judgements.
- A highly effective foreclosure law and procedure would not automatically stimulate housing finance, although it would incline private investors to invest more in housing finance companies. Pakistan has taken the right step by establishing private sector, market-oriented housing finance firms, which do have the capacity to develop into effective resource mobilization institutions, provided that they are effectively managed and can operate in a legal environment that is at least neutral. Without such a legal environment, housing finance companies will find it difficult to make loans and difficult to expand business to meet demand.

To achieve better housing for as many people as possible, and to gain the economic benefits from stimulating the housing construction industry, it is necessary that the emerging market-oriented housing finance industry in Pakistan be able to operate in an environment in which finance policy and the law support resource mobilization and lending for housing. Presently, the financial and legal environment constrains the development of housing finance. Until it supports housing finance, neither the people of Pakistan nor its financial institutions will benefit from the great opportunities that housing finance can provide for social and economic progress.



Debt Recovery Mechanisms in Pakistan

While debt recovery is a concern of all lending institutions, foreclosure is of particular concern to housing finance institutions, since property is the security for virtually all mortgages. Housing finance has been a subsidized monopoly of the public sector, marked by poor administration. Despite special legal provisions to recover loans, repayment records have been poor. Now, as part of government policy to strengthen housing finance, new private firms are entering the market. Of critical concern to their success is whether they can efficiently recover all loans. This ability depends largely on whether the law and legal system will support their legitimate claims.

Housing finance is poorly developed in Pakistan. Almost all housing is informally financed and, until very recently, the only significant sources of formal sector mortgage credit were public sector institutions. These institutions have never met more than about 15% of the estimated demand for housing.

The lack of mortgage credit has been identified as a major constraint to the development of the housing sector. In addition, the lack of a vigorous formal housing finance sector has inhibited the deepening and broadening of financial markets, since financial instruments backed by real property are virtually unknown.

Recently, as part of its liberalization of the finance sector, Pakistan has opened the field of housing finance to the private sector. These

new firms are starting operations in the face of broadly-held perceptions that housing finance is a highly risky business with a low potential for profit.

HBFC

For almost 40 years, House Building Finance Corporation (HBFC) has been the only significant mortgage lender in Pakistan. A public sector institution, it was established in 1952 under an Act of Parliament. Although HBFC appears to have been effective in making loans, it has been notably deficient in servicing and collecting them.

HBFC has sanctioned several hundred thousand loans and presently has a portfolio

Until recently, public sector institutions have been the major source of mortgage credit in Pakistan.

These institutions meet only about 15% of the estimated demand for housing.



nominally worth an estimated Rs. 18 billion. However, only a fraction of the portfolio is performing; many of the loans have not been paid in years. Estimates indicate that about one-third or more of HBFC borrowers become new defaulters or delay their payments each year.

Studies and interviews suggest three major reasons for HBFC's poor performance: First, local administration has been weak. Notices are rarely sent that loan payments are due or past due; inadequate accounting makes it difficult for either HBFC or its clients to ascertain correct loan balances, and some payments may go unrecorded. No one at HBFC is specifically responsible for collection.

Second, business judgement has been lacking or absent when a number of loans have been originated. Although most HBFC loans are adequately secured and with borrowers who can afford to repay, many instances exist where lending decisions have been based on political or other influences.

Third, despite special debt collection powers granted in the HBFC Act, which include access to land revenue enforcement mechanisms, rarely has HBFC invoked them, or resorted to foreclosure, to force defaulters to pay. Non-performing loans are not "written off," but are simply retained on HBFC's books.

Recently, the government has directed that HBFC become "commercially viable," and has greatly reduced HBFC's access to funds at the State Bank of Pakistan (SBP). HBFC has stepped up efforts to improve loan collections. These efforts have met with some success, and have been backed up with the threat of foreclosure or seizure of the mortgaged property under the HBFC Act. Whether these efforts can be sustained is questionable.

"Commercial viability" will require that HBFC's financial performance instill confidence in private investors, so that HBFC can mobilize resources in the capital markets. Despite its somewhat better recent performance, HBFC remains far from

What needs to be done to improve the legal environment for housing finance?

- ***court procedures must be improved to ensure that decrees of banking tribunals can be finalized in a reasonable period of time***
- ***appeal rights need to be rationalized to avoid frivolous delays***
- ***enforcement mechanisms such as eviction need to be strengthened***
- ***the cost of land registration and transfer need to be reduced to bring people into the formal registration process***
- ***ultimately, land titling and registration needs significant change***

Both the lender and the borrower need a system they have confidence in.



achieving the standard necessary. To fully recover debts owed it, HBFC will require the full support of the legal system.

Commercial Banks

Some of the private and nationalized commercial banks engage in a small amount of mortgage lending, generally limited to their own employees and to employees of companies who guarantee their employees' obligation and agree to deduct monthly mortgage payments from the employee's pay. This sort of arrangement eliminates much of the risk associated with making housing loans, but it also eliminates from consideration for a loan anyone who is not employed in the formal sector of the economy or who cannot pledge easy-to-liquidate assets as security for a loan.

Private HFCs

Beginning in 1989, Pakistan initiated the development of a market-oriented housing finance system. With the assistance of the Shelter Resource Mobilization Program of U.S.A.I.D., the Ministry of Finance put in place a basic legal framework to enable private firms to enter the market for mortgage credit.

The first such private firm to become licensed, Citibank Housing Finance Company, began operations in Lahore in December, 1992. A second firm, International Housing Finance Ltd., is expected to begin operations in Karachi soon, and another five companies are at various stages in the process of starting.

Consumer interest in private housing finance is high — Citibank HFC has received thousands of inquiries about loans. Yet, actual lending has proceeded slowly. The initial experience of private HFCs reveals the weaknesses of the policy and legal environment for housing finance, including problems associated with inadequate title, high transaction costs, and inability of HFCs to have confidence that the legal system would ultimately support their legitimate claims on mortgaged property.

High stamp duties, land and mortgage registration fees, appraisal fees, and legal fees

all contribute to making housing finance unduly expensive and tend to limit access to HFC mortgages to upper-income people. Yet, an HFC must proceed with extreme prudence even in that market, putting great emphasis on cautious selection of borrowers.

Because of the problems associated with lending, HFCs will have problems mobilizing resources, especially from the capital markets. Studies and interviews show clearly that investors are doubtful about the ability of HFCs to recover loans. This reluctance will continue to make resources for housing both scarce and expensive. And, until confidence can be built in the validity of primary mortgage documents, a secondary market in mortgage-backed securities will not develop.

In summary, private housing finance can only develop slowly until both HFCs and investors have confidence that the legal basis for mortgage lending is sound and that the legal system will routinely resolve debt recovery cases efficiently.

The Legal Framework For Debt Recovery

In order for a finance institution in the business of making loans to succeed—in order for a potential financial institution to even want to enter the housing finance business—there must be fundamental assurances that loans will be paid or that they can be recovered through the legal process.

Currently, there are approximately 20,000 cases pending in civil courts and banking tribunals for recovery of various types of loans. Some of these cases have been pending for more than 10 years, and estimates indicate that approximately two billion rupees is currently tied up in loan defaults.

In Pakistan, the basic legal framework for recovery of debts is present. However, the courts do not have the necessary tools to finalize and implement foreclosure and debt recovery cases. Conversely, there is ample

Forty years of HBFC performance in the public sector has created a perception that...

- ***borrowers don't repay housing loans***
- ***housing lenders do little to collect debts***
- ***housing finance is a highly risky business with low potential for profit***



evidence that courts do not use the legal tools that are available under the law to implement debt recovery proceedings. A separate but related issue is the lack of a sound land titling, registration, and transfer system in Pakistan. This has created an environment where there is no clear irrefutable legal title to land, which constrains both lending and debt recovery mechanisms. Combined, these issues have resulted in a legal system which clearly does not operate as it was intended to.

A mortgage is the transfer of an interest in property for the purpose of securing the payment of money advanced by loan. The Transfer of Property Act of 1882 sets out the substantive body of Pakistan's immovable property mortgage law. The 1882 Act was last amended in 1929, and reflects outdated concepts of English mortgage law largely developed during the reign of Henry II, gifted to India by the Raj, and adopted virtually verbatim by Pakistan upon Partition. Six types of mortgages are specified, some of which are rarely if ever used, and others which can only be used in specific cities or by persons of specified national and religious origin. Two options are available to a mortgagee (lender) in the event of default in payment of the mortgaged money: a right to file suit for foreclosure, and a right to file a suit for sale of mortgaged property.

Although technically a provision for foreclosure is present in the 1882 Act, this right can only be enforced in a court and is only available to a specific category of mortgages, the "anomalous mortgage" or mortgage by deed, which confers the power of foreclosure by conditional sale to a lender. Due to the remedy of foreclosure that is available to the lender, borrowers seldom agree to anomalous mortgages. Therefore, foreclosure under the 1882 Act has little practical significance. The bias of equity protects the borrower's right to redemption, and in almost all instances, financial institutions must resort to sale of the property to recover a loan.

The Banking Companies Ordinance of 1979 established special Banking Courts to ameliorate many of the delays associated with

the civil court system. This legislation sought to establish a more effective mode of summons (notice) to the mortgagor by requiring simultaneous service through the bailiff's of the court, registered post, and by publication in newspapers. Under this ordinance, a defendant does not have an automatic or unconditional right to defend but must appear and apply to the court for leave to defend the suit. In addition, proceedings under the Banking Companies Ordinance are required to come up for hearing as "expeditiously as possible" with adjournments granted only in "extraordinary circumstances."

The Legal Framework:

- ***the Transfer of Property Act of 1882***
- ***the Registration Act of 1908***
- ***the Code of Civil Procedure***
- ***the Banking Tribunals Ordinance***
- ***the Companies Ordinance***
- ***the Banking Companies Ordinance***
- ***the Land Revenue Code***
- ***the IDBP & ADBP Ordinances and HBFC Act***

Similarly, the Banking Tribunals Ordinance of 1984 was intended to be an efficient scheme to permit banking companies to recover debts. Under the Ordinance, Tribunals are required to process cases within 90 days. Within 10 days



of notice, the defendant is required to show cause why the suit filed against them should not be granted. If the debtor fails to respond, or if the Tribunal rejects their reply, a decree is entered in favor of the bank. The debtor is required to deposit with the Tribunal within 15 days cash or other security at least in the amount of any missed installments. The Tribunal can, however, set the decree aside, for good cause, upon the debtor's application within 30 days of the decree's entry.

The debtor's right of appeal to the High Court is conditioned upon the deposit of the decretal amount with the Tribunal. Other than by appeal, no court can interfere with a Banking Tribunal's decision. Once a decree is final, the Tribunal can order execution in accordance with the Civil Procedure Code (CPC) of 1908, and can order that the debtor be held in civil prison.

Section 69 of the Transfer of Property Act of 1882 allows a mortgagee to sell property in some instances without intervention of the courts. For example, when the mortgagee is the Federal or Provincial Government or a banking company, intervention of the courts is not required. Similar provisions for foreclosure are available under Section 119 of The Companies Ordinance of 1984, and Sections 39 and 40 of the Industrial Development Bank of Pakistan Ordinance of 1961. In addition, foreclosure proceedings without court intervention are available to the Housing Building Finance Corporation of Pakistan under the Land Revenue Code and Section 30 of the Housing Building Finance Corporation Act of 1952.

The Legal Machinery in Action

On paper, it appears that a creditor has everything they could conceivably want by way of an arsenal of remedies. Practice, however, is a long way from what the law provides. The legal system is characterized by overworked and understaffed courts, archaic office management equipment, liberal granting

of appeals, reluctance by the courts to compel compliance with statutory time limits, procedural defects, and alleged corruption on the part of court officials, banking officials, defendants, and counsel.

Insufficient Allocation of Resources

In the civil courts, mortgage lending suits create "bottlenecks" in a system already overwhelmed with routine caseloads. Banking Courts and Tribunals established to prevent delays in the civil courts have not provided much relief. It is only fair to point out, however, that these special courts have not been provided with much relief either.

There are currently only two Banking Tribunals in Karachi and one in Lahore for the Sindh and Punjab Provinces, respectively. In the past, judicial officer positions in some Banking Tribunals have been vacant for years at a time, rendering the Tribunal essentially nonfunctional. In a case pending since 1988 in the Banking Tribunal of the Punjab, the reason cited for the cause of delay in decision is "Tribunal was not functioning for two and one-half years ending January 1992." The number of new suits instituted each year in the Banking Tribunals and Special Courts far exceed the number of cases that are disposed of. Recent legislative amendments have reduced the number of officers in a Banking Tribunal from three to one.

Insufficient physical resources allocated to the legal system compound the problem. Often, courts do not have appropriate facilities, office equipment, or support personnel to process cases in a timely manner.

Problems Associated with Implementation of the Law

As previously discussed, there are several provisions in the Banking Companies and Banking Tribunals Ordinances designed to expedite the court process. In theory, these provisions are relatively clear, fair, and are designed for rapid action. The intent of the law and actual practice, however, are markedly divergent, and loan recovery often becomes a

There are an estimated 20,000 loan-related cases pending in civil courts and banking tribunals.

Some have been pending for more than 10 years.

These cases involve an estimated 2 billion rupees in defaulted payments.



muddled litigation process which favors the borrower and drags on for years.

The courts are liberal in granting leave to the defendant, and frequent

adjournments without adequate grounds are common. In a case still pending in the Banking Tribunal at Karachi, there have been approximately 100 hearings and adjournments since 1987. Although the court is empowered under the law to grant adjournment at the cost of the party

seeking it (usually the defendant), this option is rarely enforced. When it is, the nominal charges do not serve as an adequate deterrent to the defendant, who simply pays a small fee, if any. The laxity of the courts in granting adjournments without cost has led many lawyers to take these forums for granted. In such an overloaded court system, perhaps judges are not likely to resist with much enthusiasm defendants and counsels desire for delay.

Once leave is granted, suits become subject to a number of tactics designed to thwart the recovery process. As the Civil Procedure Code of 1908 requires joinder in the proceedings of anyone with an interest in the mortgaged property, borrowers often misuse this provision to transfer property interests to third parties for purposes of delay. This is relatively easy to accomplish. For example, in rural areas of the Punjab it can be done quite simply through an Oral Gift of Land, which is not required to be registered under Islamic Law.

There have been several cases in which defendants invoke the jurisdiction of the High Courts and Federal Shariat Court on the plea that the recovery suit involves a contract based on Riba (interest), and is therefore not enforceable under Islamic Law.

Collusion between any number of parties have rendered expeditious proceedings nearly impossible. In the past, defendants often avoided the service of summons from the

court, and there was a general perception at large that many of the process-serving staff of the courts were in league with defendants. In one case in the Special Banking Court in Lahore there were 67 hearings and adjournments from June 1981-February 1991. The cause of delay in securing the decree was cited as "delay in service of notice... non-

availability of the whereabouts of borrower."

In a case in Karachi, there have been approximately 100 hearings and adjournments since 1987.

In a case in Lahore, there were 67 hearings and adjournments between 1981 and 1991.

Execution of Decrees

Execution of decrees does appear to be a much larger problem than the language of the law suggests it should be. The process for execution set out in the Code of Civil Procedure is archaic, time consuming, and subject to challenge and frustrations.

In a suit for foreclosure where the plaintiff succeeds, the court will pass a preliminary decree for an account to be taken of all the amounts due to the mortgagee. If the defendant pays the amount within six months, the plaintiff must retransfer the property to the defendant. The court may, as its discretion, extend the borrower's time for repayment.

Under the CPC, all persons having an interest in the mortgaged property or in the right of redemption must be joined as parties in the suit. Once again the defendant may enlist parties to claim interest in the property. In some cases, independent suits may be filed. From a legal perspective, such suits may be doomed from inception, however, they serve to push the recovery procedure through another legal loop.



In a case from 1985 in the Lahore High Court, execution proceedings are still pending due to obstacles employed by the debtor to prevent auction of the property. Once an appeal to the High Court is granted, there is no established time frame for the execution of a decree, and cases can remain undecided for years.

In some instances, members of communities have used their power and influence to frighten away potential bidders from property auctions. In these cases, no one may show up at an auction. Similarly, there have been allegations of collusion between debtors and court officers responsible for conducting foreclosure sales.

An English Judge of the Primary Council once remarked that in the sub-continent the problems of the litigant start after obtaining a decree in their favor.

Too true...

In a case from the Lahore High Court in 1985, execution of the court's decision is still pending due to maneuvers by the debtor to prevent auction of the property.

A significant problem at the execution stage of a decree is obtaining vacant possession. In many cases, the owner or the tenant may simply refuse to vacate the property. Sometimes, third parties are enlisted to claim an interest and establish residence on the property. Assistance from the police often gives rise to problems of its own. Commonly, lenders have to proceed through the civil court

system under the Civil Procedure Code just to have a decree executed to obtain vacant possession of the premises. At this point, the suit may already have been tied up in litigation for several years.

The court is generally reluctant to turn families out of their home. Often, when the lender is able to obtain vacant possession, it is difficult to find a buyer. It has been suggested that superstition and a distaste of profiting from the misfortunes of others can be a deterrent to property sales (Kabraji, 1993).

Where the lender is unable to obtain vacant possession, the proceeds of the sale are only a fraction of the true value of the property. In addition to the social stigmas discussed above, buyers simply do not want to buy a house that is not vacant at the time of sale or that may involve them in costly and time-consuming legal proceedings just in order to occupy the house. These tactics do not serve justice to either party in the long run. Clearly, when a prospective purchaser can look forward to immediate possession, the chances for the sale yielding a price close to market value are enhanced. This would benefit the lender, of course, who can have their obligation satisfied in full. But it also would benefit the borrower, whose chances for recovery of some portion of equity (the difference between the sale price and the outstanding amount of the obligation) are substantially increased.

As previously discussed, there are several laws that allow the mortgagee to sell property without intervention of the courts. These mechanisms do not appear to be adequate in practice, as intervention of the court ultimately becomes necessary to enforce them. In such cases, district judges usually favor the borrower and allow them time to pay their outstanding debt in installments. Buyers seem especially reluctant to purchase where the bank is exercising its statutory right of sale because they fear the possibility that the transfer of the title could be impeached by the borrower in some manner.

The elimination of interest in the domestic financial structure and the resulting lack of any increased financial liability do not serve as an

Judges do not have the appropriate courtroom facilities, office equipment, or support staff to dispense justice in a timely manner.



In Pakistan, the current system of land titling, registration, and transfer offers little if any security to lenders, and make it very risky for financial institutions to make housing loans.

adequate deterrent to prolonged proceedings. In some cases, a delinquent borrower may welcome proceedings for this very reason. Similarly, a borrower may take action in the civil courts against the lender, alleging that they have suffered damages due to delay in the lenders organization, with the intent to obtain compensation by way of extensions in repayment or rescheduling. This leaves the lender defending a multitude of proceedings to the strategic advantage of the borrower (Kabraji, 1993).

Time is money to housing finance lenders, who depend on timely repayment of loans to keep their businesses on an operational and ultimately profitable level. The delaying tactics adopted by defendants are often with the intent to wear the lender down to an eventual compromise. In view of historically poor rates of recovery, many lending institutions ultimately acquiesce to negotiations and eventual settlement in an attempt to minimize their losses. Clearly, lending institutions suffer heavy financial losses and can not operate for long in this sort of legal environment.

Land Registration, Titling, and Transfer: Costs and Implications

Land title is essential to the housing finance lending and recovery process. A lenders security for a housing loan is the borrowers property. In order for a lender to have a reasonable "comfort level" that the property can be recovered in the event of default, there must be assurances that the property actually belongs to the borrower, and therefore, can be taken by the lender to recover a loan if it becomes necessary. In Pakistan, the current system of land titling, registration, and transfer offers little if any security to lenders, and make it very risky for financial institutions to make housing loans.

Pakistan has a system of record keeping for collection of land revenue which was developed during the Moghul period. Under this system, all title documents must be registered under the Land Registration Act of 1908. Failure to register any document makes it legally ineffective. Stamp duties, high land

transfer fees, registration fees, and collateral wealth tax liabilities have all been major factors in discouraging the proper recording of land transactions. Most land is not legally registered, and transfers are often not recorded for a long time, if at all. As a result, there is no single record which is conclusive and irrefutable evidence of land title.

Taxation, stamp duties, and costs of registering property related transactions are major problems for registering land and mortgage documentation.

Poor land titling and registration have made it difficult for the courts to provide timely remedies to financial institutions in loan recovery cases. Much of the litigation that takes place is simply trying to establish who is the legal owner of the property in question. No clear system of legal transfer of land makes it relatively easy for borrowers to transfer property interests to third parties in an attempt to undermine the recovery process. To avoid high costs associated with registration, borrowers often deposit title deeds with lenders as security for their loans. This sort of equitable mortgage arrangement, unlike other types of mortgages, is not compulsorily registerable. The equitable mortgage, however, has the disadvantage that it does not serve as a notice to the world at large and it exposes the lender to the risk of defective or fake title deeds. While in practice prudent bankers insist on a registered mortgage to overcome such risks, it adds to the costs of the borrower.

Pakistan does not have a formal land appraisal system. High rates of stamp duties have given rise to a tendency to understate the actual sale



price of property. So if there is a registered sale deed, it often does not reflect the true value of the land and any prospective lender may be lending more than the registered value of the property. In such cases, the lender can only minimize, but not eliminate the risks that are inherent in a system where there is no compulsory system of registration.

Conversely, interviews reflect that political pressure or collusion of banking staff and borrowers can result in exaggerated land values. In this case political loans are often given without adequate security and are seldom repaid. A functional land transfer and registration system would help reduce this type of fraud.

The debtor's options...

- ***Ask frequently for adjournments due to —***
 - ***Counsel preoccupied in higher courts***
 - ***Illness***
 - ***Bereavement***
- ***Transfer property interest to a third party; have the third party join the suit or file an independent suit***
- ***Avoid court summons (bailiffs seem remarkably able to arrange this)***
- ***Exercise your seemingly unlimited rights to appeal***
- ***Argue that the mortgage contract is unenforceable under Islamic Law***
- ***“Persuade” the lender’s staff to help your case***
- ***Create obstacles to foreclosure auction sale of the property***
- ***Refuse to vacate the property***

...are endless.



Experience in the Region

In the search for ways to strengthen the legal environment for lenders in Pakistan, research was carried out in Malaysia, India, and Sri Lanka. These countries all have housing finance systems that are more developed than that in Pakistan. The three systems demonstrate the strong linkage that exists between finance policy, the legal environment, and housing finance.

MALAYSIA

Government Policy and the Growth of Mortgage Lending

It is a policy of the Government of Malaysia to facilitate and provide institutional support to the growth of the private housing sector. At least 70% of houses built in new complexes in Malaysia must be in the low to medium cost category. The Malaysia Building Society Berhad (MBSB) and the Perneo Building Society Berhad (BBSB) have played a major role in lending for housing. Growth in lending by these institutions is steady, however, in the last several years, their lending activities have been surpassed by commercial banks, finance companies, and the government.

The rapid growth in lending for housing represents a major source of resource mobilization within the Malaysian economy. Commercial banks operate as HFCs and are required to invest 5% of their assets in low and medium cost housing. It is estimated that housing loans now represent about 16% of the outstanding portfolios of commercial banks, and 20% of the outstanding portfolios of

finance companies. Several housing finance companies are established in the private sector.

Several factors contribute to a healthy housing finance environment in Malaysia, including effective primary recovery mechanisms, a strong legislative and regulatory framework, clear land titling, registration, and transfer mechanisms, and a workable process for foreclosure.

Effective Management

Management of HFC's in Malaysia is efficient and effective, and the average rate of recovery of loans approaches 97%. An effective system of loan accounting and collection has been developed. Banks and HFCs employ strict appraisal of loan applications with a goal to obtain payment promptly at a minimum cost while maintaining a good relationship with the borrower. Collection efforts are applied in proportion to the delinquency status of the account, and the maximum time frame allowed for repayment usually does not exceed the due date of the next payment.

In many institutions, computer-aided collection systems have enhanced the effectiveness of the underlying infrastructure for loan recovery

The rapid growth in lending for housing represents a major source of resource mobilization within the Malaysian economy.



In Malaysia, commercial banks operate as HFCs and are required to invest 5% of their assets in low and medium cost housing.

For example, Citibank at Kuala Lumpur employs 5 officers and 13 collectors to handle up to 26,500 accounts. The default rate at Citibank is only 2.6%.

Malaysia:

- **Supportive National policy**
- **Effective Institutional Management**
- **A Strong Legislative and Regulatory Environment**
- **A Uniform system of land tenure, titling, registration and transfer.**

The Legal Environment

There is a strong legislative and regulatory framework for housing development in Malaysia under the Housing Developers Control and Licensing Act of 1986. This act requires housing developers to obtain a license from the Controller of Housing. Developers are required to keep the Controller informed of corporate changes, appoint auditors, and regularly submit audited reports of their accounts.

In turn, the Controller is required to monitor the performance and conduct of developers. Developers found guilty of offenses under the Act may be prosecuted in a court of law and fined and/or imprisoned for up to three years.

Housing developers are also required to maintain a Housing Development Account. This account is operated by the banks or HFCs and prevents potentially unscrupulous developers from misusing mortgage funds by

ensuring that all money deposited and withdrawn from the account is done in accordance with the Housing Developers Control and Licensing Act. In addition, a standard Sales and Purchase Agreement is utilized in Malaysia to safeguard the interests of both developers and home buyers.

Land Registration, Title, and Transfer

There is a clear system of land titling, registration and transfer in Malaysia. British land management systems have been replaced by a more effective system based on Australian land management concepts.

Under the National Land Code of 1965, a uniform system for land tenure, titling, registration, transfer, and collection of revenue has been introduced in all states. Land is surveyed and demarcated by state governments, and all land is registered in the State Registry, including easements and encumbrances. As a result, title to land is clear in Malaysia and does not become an issue in loan recovery.

Stamp Duties

Like many other South Asian countries, stamp duties on secured documents in Malaysia are exorbitant. Increasingly, these costs are being circumvented by banks and other financial institutions by accepting promissory notes. Promissory notes carry a nominal stamp duty of RM 5.00, whereas loan agreements carry stamp duties at 5% of the value of the transaction. Under this arrangement, the financial institution relies on its offer letter with signed acceptance by the borrower. Unfortunately, anything less than secured registration can create problems in the courts later on.

Debt Recovery in the Courts

The lower courts in Malaysia have been functioning quite well in relation to neighboring South Asian countries. The law allows service of respondents by the petitioner's attorney, which expedites service of court process. Following a series of letters



of reminder and personal visits to the borrower, and subsequent letters of demand by the financing institution and legal counsel, court proceedings are initiated, usually within 65 days of nonpayment. The plaintiff's attorney serves the defendant, files a sworn affidavit before the court, and the foreclosure process is initiated. The time frame for proceedings and implementation of property foreclosure is approximately 15 months to two years.

Credit Bureaus, Rating Agencies, and Trade Associations demonstrate the opportunities that exist in South Asia for institutions which focus on preventative management.

Conversely, the Malaysian High Court has been experiencing three to five year delays in bringing cases to trial. In response, the jurisdiction of the lower courts has been increased. Recently, statutory amendments have been proposed to raise their jurisdiction over cases from the current RM 100,000 to RM 250,000. Although this will decrease the burden on the High Courts, it may result in simply shifting the pressure of increased case loads to the lower courts.

Malaysia has taken other steps in an attempt to expedite court cases. In the High Court, Judicial Commissioners have been appointed to clear the backlog of cases. Judicial Commissioners are appointed for a fixed term and enjoy the same powers and privileges of a High Court Judge. In addition, Small Claims Courts, which do not allow legal representation, have been established for settlements up to RM 5,000. Cases are dispensed of quickly while minimizing costs.

There is only one appeal allowed against the orders of the High Court to the Supreme Court in Malaysia. This appeal can be filed only on

points of law, e.g. capitalization of interest, inadequate stamping of documents, or valuation of property. About 1% of defendants appeal to the Supreme Court, where appeals are decided in one to three months.

Credit Bureaus, Rating Agencies, and Associations

The Central Bank of Malaysia has established a Central Credit Bureau which collects and classifies credit information on existing as well as potential borrowers. This information is disseminated among financial institutions. In Pakistan, the State Bank has established a similar system, however it has not made the information equally available to other financial institutions.

The Rating Agency Malaysia Berhad (RAM) was started by various commercial banks, finance companies, and merchant bankers in response to an emerging corporate bond market in Malaysia. RAM carried out credit assessments and analysis on private debt securities. This is an arrangement geared toward preventing default as opposed to recovering debt.

Finally, financial institutions in Malaysia have formed various associations. These have helped strengthen the financial community's collective voice in addressing issues arising during the course of business. These associations also provide credit information to their members.

INDIA

Background

The evolution of formal housing finance in India began in 1970 with an apex financial institution — the Housing and Urban Development Corporation (HUDCO). HUDCO was established with the goal of accelerating the pace of housing and urban development schemes. It provides low interest loans to state governments, local housing societies and boards, and other housing development agencies. HUDCO has been expanding its operations successfully for over

There is only one appeal allowed against the orders of the High Court to the Supreme Court in Malaysia.



Commercial banks in India are required to invest 1.5% of their incremental deposits in the housing sector.

two decades without any serious debt recovery problems. Despite providing loans at subsidized rates, HUDCO earned a sizeable profit in 1990-91.

In 1977, the Reserve Bank of India appointed a Working Group on Housing Finance to examine the role of the banking system in providing finance for housing schemes. At that time the concept of mortgage lending through a specialized institutional framework began to receive attention. In 1978, The Housing Development and Finance Corporation (HDFC) was established in the private sector.

In 1988, the National Housing Bank (NHB) was established as a subsidiary of the Reserve Bank of India. NHB is responsible for promoting, supervising, and regulating the housing finance industry. NHB serves as an Apex Bank and provides loans to various HFCs at subsidized rates.

Commercial banks in India are required to invest 1.5% of their incremental deposits in the housing sector. Many commercial banks have set up HFCs as their subsidiaries, and the Life and General Insurance Corporations of India have set up similar subsidiaries as well. Equity in several subsidiaries is also held by the NHB. Currently, there are approximately 200 HFCs in the private sector.

The Legal Environment

India's housing finance environment, like Pakistan's, is constrained by an inadequate legal environment. It is a struggle to recover defaulted loans. HFCs in India do not have any special mechanisms for their claims or for enforcement of mortgage contracts with borrowers. In case of default, HFCs have to proceed against the defaulting borrower in civil court under the Civil Procedure Code. Provisions for multiple appeals further delay the process. Even after obtaining a final decree, its enforcement can often become extremely difficult, time consuming and costly. A suit for enforcement of mortgage in India can take well over 10 years.

Chief Justice of the Supreme Court of India Mr. Justice P.N. Bhagwati observed in a Law Day speech on November 26, 1985:

"I am pained to observe that the judicial system in the country is almost on the verge of collapse. These are strong words I am using, but it is with considerable anguish that I say so. Our adjudicatory system is creaking under the weight of arrears..."

In the Statement of Objects and Reasons attached to the Recovery of Debts Due to Banks and Financial Institutions Bill of 1993, there were more than 1.5 million Public Sector Bank cases involving more than Rs. 5,633 million, and 304 All India Public Financial Institutions cases involving approximately Rs. 3,910 million. On March 31, 1991, the Reserve Bank of India reported Rs. 7,578.6 million was outstanding in 446,018 decree accounts.

The Supreme Court of India recently stated:

"This Court has no time even to dispose of cases which have to be decided by it alone and by no other authority. Large numbers of cases are pending from 10 to 15 years. Even if no new case is filed in this Court hereafter, with the present strength of judges, it may take more than 15 years to dispose of all the pending cases."

Land titling, registration, and transfer procedures are cumbersome and a large number of transactions are illegally performed to avoid high titling charges and taxes. Lack of clear title to land has complicated the debt recovery process, and is currently an impediment to the further growth of the private sector housing finance industry.

To avoid stamp duty and registration charges required to register Simple Mortgages, Equitable Mortgages are created by depositing property title documents with HFCs as security for housing loans. Under an Equitable Mortgage arrangement, HFCs do not have a right to foreclosure, but must proceed through the civil court system for the sale of property



under the Civil Procedure Code. A written memorandum, which documents the deposit and creation of the mortgage, accompanies the deposit of title deeds and is not required to be registered. However, if the memorandum is the contract and constitutes the "bargain" between the parties then it must be registered, and is subject to excessively high stamp duty in most Indian States.

The Management Environment

Although the legal environment is not conducive to housing finance, exemplary management systems have enabled India to make progress toward a stable housing finance system in both the public and private sectors. HDFC and other well-organized HFCs have mastered credit risk analysis, avoid risky borrowers, and quickly follow up on late payments.

For example, there are only 729 employees at HDFC. These employees are highly trained to effectively sanction and monitor loans through a committee system. No single individual is authorized to approve loans, which reduces the potential of loans resulting from poor judgement or singular persuasion.

HDFC does not make loans unless they are relatively sure that the borrower will repay. Eighty percent of HDFC borrowers are salaried employees and 20% are self-employed. HDFC usually does not grant loans to self-employed individuals unless they are tax payers. Loans are secured by two personal guarantees and a life insurance policy. Prudent HFCs in India insist on registered mortgage deeds and a borrowers clear title to land.

Computerized application, loan processing and accounting systems provide effective monitoring for rapid follow up to delinquent loans before they become a serious problem. HDFC has 26 autonomous fully computerized branch offices.

Branch managers at each office are responsible for following up on accounts during the first 90 days of delinquency. As in Malaysia, letters are sent, followed by phone calls and personal visits. Visits are often made to the business

office of the borrower in an effort to exert additional pressure. Branch loan committees are responsible for approving loans up to 300,000 rupees. Larger loans must be approved by the Main Office at HDFC. Recovery rates exceed 98%, and in 14 years of operation, HDFC has found it necessary to resort to foreclosure proceedings in only 15 cases. Last year, HDFC declared a dividend of 24%.

In India it is a criminal offense to write a check with insufficient funds in the bank to cover it. This has been a strong weapon for HFCs in India to pursue loan defaulters when bad checks are involved.

Due in part to the success of the housing finance system, housing is no longer considered a social welfare sector in India. In 1992, the government adopted a policy which states that housing is an important economic sector which contributes to employment, mobilizes savings, and increases domestic productivity.

Recent Proposals to Improve the Lending Environment

The inadequacy of debt recovery mechanisms in India have constrained the growth of housing finance. HFCs require high securitization of loans from borrowers. This limits the amount of money that can be borrowed from a lender. It also limits loan access to individuals who have relatively high incomes and substantial existing assets.

Constraints in the current debt recovery process has caused cautious creditors to limit their lending to HFCs, and this inhibits resource mobilization. Only HDFC has established its reputation and is fully capable of mobilizing resources; other firms rely heavily on assistance from the National Housing Bank.

Recently, proposals have been made in an effort to make more loans at higher values available, and to increase the comfort level of investors to mobilize resources. The NHB has proposed legislation that would allow HFCs to recover loans without court intervention. After

Successful management systems in India:

- ***Credit risk analysis***
- ***Computerized loan application, processing, and accounting systems***
- ***Rapid follow-up on late payments***



The inadequate legal environment in India constrains the growth of housing finance.

appropriate notice to the borrower, the NHID would have the authority to transfer property by lease or sale and recover the outstanding amount of a loan due to HFCs from the sale proceeds of the property.

On May 13, 1993, the Recovery of Debts Due to Banks and Financial Institutions Bill of 1993 was introduced in Parliament with the stated objective of fulfilling a "long-felt need" to set up special Banking Tribunals for recovery of debts of banks and financial institutions, thereby releasing significant amounts of public funds locked up in litigation and recovery.

The proposed Banking Tribunal system in India is two-tiered. The first tier of the Tribunal will hear debt recovery cases. It will be headed by a single judge, and will include a Recovery Officer and other officers as thought fit. The second tier will consist of an Appellate Tribunal to exercise review over appeals. The Appellate Tribunal will be headed by a single judge with qualifications or experience as a High Court Judge or a member of the India Legal Service.

Under Section 18 of the Bill, the jurisdiction of the civil court system is superseded in matters which fall within the Tribunal or Appellate Tribunal's jurisdiction. The procedures for hearing by the Tribunal are summary in nature. Unless the Tribunal rules otherwise, the Appellate Tribunal is available only upon deposit of at least 75% of the determined debt. Under Section 31 of the Act, all existing relevant suits and other proceedings will be transferred to the Tribunal with the exception of appeals.

SRI LANKA

Background

Sri Lanka has a public sector dominated housing finance system. The Ministry of Housing and Construction in Sri Lanka is responsible for framing and implementing a national housing policy that promises shelter to every Sri Lankan by the year 2000.

The National Housing Development Authority (NHDA) of Sri Lanka is the implementation arm of the government. Set up in 1970 to finance low cost housing, it has been very ineffective - NHDA has over 7,000 employees and a loan recovery rate of approximately 30%. Commonly, the public views NHDA as a source of grant funds and is reluctant to repay loans. Unfortunately, what once started as an agency to support shelter for low income families is now a bankrupt agency that has not achieved its social goals.

However, several public sector agencies are experiencing success with housing finance activities, including The Central Bank of Sri Lanka, The State Mortgage and Investment Bank, and the National Savings Bank. The Central Bank regulates all public and private commercial banks as well as non-bank financing institutions.

In 1984, under the Housing of Ministry, Sri Lanka set up the Housing Development Finance Corporation (HDFC). HDFC receives long term loans from the NHDA at subsidized rates of interest. The Asian Development Bank has provided a \$40,000,000 Housing Loan Credit to Sri Lanka and the HDFC is receiving 9% of the funds from this program. In return, the government of Sri Lanka has agreed to privatize HDFC within the next four years.

Private sector non-bank financial institutions like finance and leasing companies are allowed under the Finance Companies Act of 1982. There are currently three leasing companies. A handful of finance companies in Sri Lanka do a few hundred housing loans each year at an annual interest rate of approximately 28%. Their main business is consumer credit.

Low Default Rates and Effective Foreclosure Law

Three years ago, with prompting from the Central Bank, the Government of Sri Lanka commissioned a committee to study debt recovery issues. Based on the recommendations of the committee, the government of Sri Lanka passed 14 amendments to existing legislation and passed new legislation which gave power of sale to



banks and financial institutions in instances of default. Three of the amendments are particularly significant to mortgage lending

Recovery of Loans by Banks (Special Provisions) Act No. 4 of 1990: Under this Act, if a lending institution has advanced monies on the security of movable or immovable property, the institution is entitled to move in, take control of the assets, and manage them until full repayment is achieved.

Alternatively, the Board of Directors can pass a resolution enabling the institution, after appropriate notice, to sell the mortgaged property and recover the monies due from the borrower. Intervention of the courts is not required, and consequently, delays associated with judicial proceedings are eliminated.

There has been serious concern that the power of parate execution, previously enjoyed only by public sector institutions, is an infringement on the basic rights of the debtor. Parate execution allows commercial banks to be the judge in their own cause and to recover monies which they decide is due to them without debtor recourse to the courts. To date, it appears that no parate execution cases have been filed in Sri Lanka. It is believed that any attempt by creditors to exercise these new rights would, at a minimum, provide frequent occasions for breaches of the peace.

Mortgage (Amendment) Act No. 3 of 1990: Under this Amendment, if the lending institution obtains an appropriate declaration from the Borrower, the lender is entitled not only to the sale proceeds of the mortgaged property, but is also entitled to sue for the recovery of any deficiency by the sale of other assets belonging to the borrower.

Debt Recovery (Special Provisions) Act No. 2 of 1990: Under this act, an institution that has lent money without the security of movable or immovable property may take action which entitles it to obtain, without notice to the borrower, an interim order which will be made absolute unless the borrower deposits the full amount of the claim, provides security, or shows reasonable cause for the default.

Therefore, it follows that unless reasonable cause is shown, the lending institution's claim is well secured by either a deposit or by security provided to the satisfaction of the court.

Unfortunately, quick recovery legislation has not had much effect on the expansion of the housing industry in Sri Lanka, and due to the lack of private sector institutions engaged in housing finance, this legislation has not been used to any great extent. However, it is in place and should form a sound legal basis for the future development of housing finance.

The National Savings Bank (NSB) is an important arm of the government for mobilization of savings and deposits. NSB has a detailed procedure for loan application appraisals. In addition, lawyers perform title searches before loans are approved.

Under the National Savings Bank Act, the bank has the power to sell mortgaged property without court intervention in cases of default. Authority under the act has served as an adequate threat to borrowers, who usually pay up the arrears when informed of the consequences of default. The NSB has resorted to sale of property to recover funds in only five instances.

The HDFC is regulated under the National Housing Act. Court action is not required for foreclosure under the National Housing Act, therefore debt recovery is relatively straightforward and efficient. HDFC issues a series of notices to defaulters and if no response is received HDFC can proceed to sell the mortgaged property. After the sale, it takes approximately one month to process court orders to vacate the premises. Police intervention is rarely required.

From the time action is initiated, it takes approximately four to six months to implement a foreclosure. It is the HDFC policy, however, to wait six months before initiating foreclosure action on delinquent accounts. HDFC currently has a portfolio of about 2,500 loans and a recovery rate that exceeds 90%.

The Sri Lankan example demonstrates that effective debt recovery systems and foreclosure laws do not automatically generate a strong flow of resources into housing credit; resources and effective institutions are also needed.

However, when resources become available, Sri Lanka's legal situation provides the basis for rapid expansion.



Multiple land registration systems in Sri Lanka have not created significant problems because lawyers conduct title searches before loans are authorized.

Land Registration Systems

There are several different land registration systems operating in Sri Lanka. None of these are very effective modern titling and registration systems. However, since financial institutions use lawyers to do title searches before authorizing loans, multiple registration systems have not posed a significant problem to establishing clear title to land. In addition, all property evaluators in Sri Lanka must be licensed. These activities have provided housing finance institutions with improved indicators of value and a certified title to the property being mortgaged, thereby reducing their lending risks.

Credit Information Bureau

A Credit Information Bureau has been established in Sri Lanka which is a resource for information on borrowers from all private and public commercial banks as well as the few existing consumer finance companies.

Unfortunately, the current system does not include information on good credit customers, but tracks only borrowers who have not made payments in a timely fashion. Furthermore, it does not provide a list of outstanding financial obligations, so a potential lender is unable to determine if a potential loan may be "the straw that breaks the camels back." Nonetheless, this is a positive step toward reducing lending risks through preventative techniques.

Successful Cooperative Societies

Cooperatives are quite popular and successful in Sri Lanka, and are governed by the Cooperatives Act of 1972. Approximately four million people in Sri Lanka are members of cooperative societies. There are over 1000 Cooperative Rural Banks (CRB), 7000 small rural Thrift and Credit Cooperative Societies (TCCS), and 287 Multiple Purpose Cooperatives (MPC) in Sri Lanka.

The Cooperative Rural Banks are one of the major resource mobilizers in the country. Although the main focus is small loans in the

area of agricultural production, a significant amount is in housing finance. Most of the housing mortgage loans are through Rural Banks. Each Rural Bank has a credit committee responsible for appraising loan applications.

The Thrift and Credit Cooperative Societies are generally small with an average of 120-150 members. This allows them to focus on their local community, and their small size and personal familiarity with members and clients seems to be a basic ingredient of their success as members often exert pressure on one another to repay loans. Recovery rates are approximately 96%. Their main focus is agricultural lending and small housing loans.

Each Multiple Purpose Cooperative has two Cooperative Rural Banks, the 287 Multiple Purpose Cooperatives have a total of 1,098 Cooperative Rural Banks. Multiple Purpose Cooperatives report their financial activities and operations to the Registrar on a quarterly basis. Their subsidiary Rural Banks report financial activities either on a monthly or quarterly basis. The main focus of the MPCs is consumer lending and housing loans.

Proposed Special Courts

In Pakistan, special Banking Tribunal Courts have been established. India is in the process of developing a two-tiered Banking Tribunal system. In Sri Lanka, delays in court proceedings have also increased pressure to establish special courts.

The Federal Cabinet is seeking to establish "Commercial Courts" to deal with debt recovery cases and a wide variety of other commercial cases through an amendment to the Judicature Act. In Colombo, three new courts have been proposed to hear only commercial cases. Due to the expense involved in setting up new courts, the government would use two existing High Courts and vest them with special commercial jurisdiction. However, it is not clear what will replace the current work performed by these High Courts.



Issues for Action

The basic legal framework for foreclosure is present in Pakistan. There is the standard legal process of notice, response, determination and appeal. Unfortunately, in practice, the process is not working very well. Debt recovery cases can take more than 10 years to resolve in the Civil Courts, and specialized Banking Tribunals, which can provide rapid decisions, have not provided much relief.

In the emerging market-based housing finance system, Pakistan must have a legal and policy environment that effectively, efficiently, and consistently promotes justice between the rights of lenders and the rights of borrowers.

Based on the results of the research carried out for the SRMP in the region, following is a summary of issues regarding debt recovery procedures and practices in Pakistan. Recommendations, where present, are of a preliminary nature, and are intended to provide a forum for further analysis by housing finance professionals and policy makers.

Court Resources

It is clear that there are an overwhelming number of cases in the various banking courts. Several of the cases studied for this report reflected that lack of a functioning Tribunal was a significant factor in delaying debt recovery suits.

Would improvements in the overall effectiveness and functioning of existing Tribunals ultimately result in a manageable case load? Is the number of Banking Tribunals currently so inadequate that they need to be

increased regardless of their ultimate efficiency?

Finalizing Court Action

The Tribunal Courts do not have an effective process for finalizing decrees. The greatest impediment to enforcement of foreclosure is the defendants unlimited right to appeal. Once a decree is entered against a defendant, the defendant can pay the missed installments, appeal, and create additional delays in the Civil Court system.

The right to appeal is a basic right and should not be removed, but it can and should be limited only to pertinent legal questions in a recovery suit. In Malaysia, for example, there is only one appeal against the orders of the court, and that is to the Supreme Court. Such an appeal can only be filed on points of law, i.e. capitalization of interest, inadequate stamping of documents, or valuation of property. In Malaysia, only 1% of defendants appeal to the Supreme Court, where appeals are finalized in one to three months.

A second, more stringent measure at the time a decision is entered against a borrower would be to require them to deposit within 15 days

New commercial courts are being established in Sri Lanka to deal with debt recovery cases.



The right to appeal is a basic right and should not be removed, but can and should be limited only to pertinent legal questions in a recovery suit.

not only the missed or defaulted contract installments, but the entire principal and interest outstanding on the contract. This would shift the burden from the lender to the borrower and provide the necessary incentive for the borrower to make good on their contract.

Requiring the entire principal and interest due is a standard practice in Malaysia and in western countries such as the United States. In order to improve the foreclosure process in Pakistan, the court system must enforce contracts between lenders and borrowers.

Mechanisms for Collection and Eviction

Finalizing court actions is the first step in making the foreclosure process function efficiently. A second and equally important step is to provide an effective mechanism for collection or eviction.

Currently, police actions in matters of collection and eviction are limited and sporadic at best. In light of this, there have been suggestions to set up a special police force with the singular task of carrying out collection and eviction decrees.

A second option would be to provide the existing district police force an incentive to take appropriate action. This incentive could be a percentage of the outstanding amount due in the case of a collection, and a fixed amount to carry out an eviction.

Judicial Independence

Ultimately, the responsibility for enforcement of collection or eviction rests with the local Deputy Commissioner and District Police Force. In addition to responsibilities as a revenue collector, the Deputy Commissioner has political, law enforcement, and local, administrative, and development responsibilities.

At the top of the government pyramid, the judiciary is separated from the legislative, political, and administrative arms of government, but at the local level, the Deputy

Commissioner has authority over all three branches of government. This can create a basic conflict among the three branches, and in some instances, political and law enforcement issues may take precedence over revenue collection and eviction issues, particularly if the latter have the potential to do political damage. This report does not propose a major change in local government structure, but only wish to point out the potential difficulties the Deputy Commissioner faces in carrying out multiple roles in the community.

Accountability

The results of this study suggest that the legal *procedures* in Pakistan favor the borrower. In many instances, the courts do not appear to use the legal *mechanisms* that are present to promote a neutral environment of justice between the lender and the borrower. There are provisions in the law that limit adjournments and require expeditious proceedings. Often, these provisions are not followed. What is needed is to make the court use the existing provisions of the law more effectively? Should Banking Courts and Tribunals be subject to oversight and inspection by the Superior Judiciary? What would a workable system of checks and balances look like?

Land Titling

A sound land titling system is necessary to the growth of a strong housing finance system in Pakistan. The basis for debt recovery and foreclosure is legal title to land. Currently, uncertainty in land titling and registration makes it very difficult for financial institutions to lend in the housing sector.

Poor titling and land registration has made it equally difficult for the courts to provide timely remedies to financial institutions in loan default cases. Indeed, such a system is necessary for collecting land revenue and would boost the economy in general. Malaysia has overhauled its British land management system. India is painfully aware of the constraints placed on development by their antiquated land registration system and is



beginning to do something about it. It would be wise for Pakistan to follow suit.

There are several shorter term solutions which would improve the existing situation, where due to the high cost involved, the majority of land transactions take place outside the formal registration system. To bring land transactions back into the existing registration system there needs to be a major reduction in the stamp duty tax imposed by the Provincial Governments. If this tax were reduced, it is likely that lower fees would be offset by a significantly higher number of transactions.

Land and land use influence each of us on a daily basis. Bringing some semblance of order and certainty to the land registration and transfer process is greatly needed in Pakistan. More certainty in land transactions would bring faster and more efficient development in many sectors of the economy. The Government of Pakistan may wish to consider an administrative structural adjustment which would separate the land registration, transfer and titling function from other administrative processes. While the cost of implementing such a change will be expensive, the cost of leaving the existing system in place will be far more expensive over time.

Other Recommendations

Several peripheral recommendations regarding debt recovery are discussed below. Implementation of these recommendations may reduce the overall number of cases brought to court for debt recovery and foreclosure.

Criminalizing Bad Checks: As currently practiced in India, dishonoring checks due to inadequate funds would provide a powerful tool to assist the borrower in collecting defaulted payments when a bad check is involved.

Title Search Requirement: In Pakistan, there is no legal requirement for a formal title search

to establish clear title to a property prior to its transfer between parties. Requiring such a search by law would strengthen and improve the quality of land titles in Pakistan and would reduce the number of court cases involving titling issues.

Credit Bureau Promotion: There have been efforts to establish a Credit Bureau in Pakistan which, over time, can provide critical information to lenders regarding the credit worthiness of prospective borrowers. This is an area which, if strengthened, can reduce the number of bad loans and in turn lower the number of court cases.

Licensing Property Evaluators: There are only a few professionally trained property appraisers in Pakistan. Currently, there are no standards or licensing requirements established for this group. Valuation of property is critical to the lender in order to establish adequate debt to equity ratios for prudent lending. Efforts need to be made to develop regulations and standards for governing property evaluators.

Licensing Developers: Developers in Pakistan should be regulated. They are entrusted with a great deal of money invested by their clients, and there have been incidents of fraud in the past. To ensure public confidence and to protect home buyers, a system of developer licensing should be undertaken along the lines of what is being done in Malaysia. This would help to reassure financial institutions and could lead to more construction financing in the country.

Project Development Accounts: Concurrent with licensing of developers, there needs to be a system in place which will control the flow of money from clients and from financial institutions providing short term bridge financing for a project. In Malaysia, Project Development Accounts, which are strictly regulated and inspected for compliance, prevent unscrupulous developers from misusing project funds.

Currently, uncertainty in land titling and registration make it difficult for financial institutions to lend in the housing sector.



Seminar Conclusions and Recommendations

On May 9, 1993, the Shelter Resource Mobilization Program of USAID, in conjunction with 21st Century Consultancy and Management Services, sponsored a national seminar on Foreclosure and Debt Recovery Laws and Procedures. This seminar was developed to promote agreement among policy makers on the actions required to improve the legal environment for mortgage lenders in Pakistan.

Over 60 participants representing the legal, government, and financial sectors, including housing finance companies and commercial banks, attended this one-day seminar. The seminar was chaired by Justice (rtd.) K.M.A. Samdani, a leading figure in Pakistan's legal community. Speakers included Mr. Earl Kessler, Director of USAID Regional Housing and Urban Development Office (RHUDO) of Asia, Mr. Mian Muntaz Abdullah, Chairman of the Corporate Law Authority; Dr. Khawaja Anjad Saeed, Director of the Institute of Business Administration at the Punjab University; Mr. Hidayat Hussain, Chairman of the Banking Tribunal at Karachi, Mr. Majid Sultan Khawaja, Chairman of the Federal Chamber of Commerce committee on Banking, Credit, and Finance, and Mr. Amjad Virk, Joint Secretary of the Ministry of Finance. A list of seminar participants is in Appendix B

Following a full day of deliberations, a clear consensus emerged that the laws governing debt recovery are adequate, and the balance of justice between borrowers and lenders is equitable under the law as it is written. However, speakers and participants emphasized growing concern regarding the ability and will of the legal system to

ultimately support legitimate claims on mortgaged property.

A primary obstacle to the recovery of debt are delays in court procedures, often characterized by the granting of frequent adjournments without punitive costs, seemingly unlimited appeals by the defendant, unchecked delaying tactics on the part of the defendants and their counsel, chronic problems in the execution of decrees and vacation of property, and a mounting backlog of cases which prevent current cases from being resolved in a timely fashion.

These delays are difficult to rationalize given the provisions of the law, and there is a perception at large that a significant component of the problem is a lack of sincere determination and will on the part of the members of the judiciary to implement the law. Repeatedly, speakers and participants from the financial, legal, and even the government community voiced the need for a more responsive legal administration for the proper execution and overall implementation of debt recovery law.



The absence of a singular system for establishing current records for irrefutable proof of title to land, coupled with undue delays in mutation and high fees charged for registration and transfer of property, have posed serious constraints on the future growth of housing finance in the country. Participants unanimously agreed that one system of compulsory land registration must be developed for the country. Likewise, the currently pervasive nature of equitable mortgages is a symptom of an unreasonable tax structure that can no longer be ignored. The primary reason for the widespread use of equitable mortgage arrangements is to circumvent the high cost of stamp duties on mortgage documents. In turn, this complicates loan documentation, thwarts the expeditious recovery of debt in cases of default, and impedes the development of economic activity in general.

At the close of the seminar, a drafting committee was formed to finalize the seminar findings and recommendations. The recommendations that follow are structured around the specific issues presented for discussion at the onset of the seminar. Additional recommendations have been added to document various views and issues of discussion that were considered to be of significance during the seminar proceedings.

Improve Judicial Determination

The Banking Tribunals Ordinance was designed to expedite court process in banking and finance cases, and following a full day of deliberations a clear consensus emerged that the law itself is adequate as written. However, as the law and actual practice are markedly divergent (it is not uncommon for loan recovery cases to proceed unresolved for years), participants agreed that the management of the court system must be improved.

In order for the mechanism of the law to function in the manner in which it was designed, judicial determination toward the implementation of debt recovery law must become meaningful and purpose-oriented—the existing provisions in the Ordinances must be

strictly applied by judges and functionaries in order for justice to be served

Improve Enforcement of Decrees

Execution of decrees are a significant problem, and amendments in the law to simplify procedures for execution, in particular to enable the decree-holder to obtain vacant possession of the property, should be considered. Tribunals should be provided with mechanisms for enforcement instead of having to rely on the district administration and the police. A possible solution would permit private agencies that are regulated by a licensed system to implement decrees. To minimize the potential for fraud and collusion, payment would be contingent upon successful execution of the decree

Allocate Resources to the Courts

The number and geographical distribution of Banking Tribunals should be increased. The Tribunals are burdened with an overwhelming volume of cases, and the number of new suits filed each year far exceed the number that are disposed of. Without a requisite increase in the number of tribunals and concurrent development of the necessary infrastructure, the volume of accumulated cases, coupled with the continual filing of new cases, will continue to prevent any significant progress in the overall disposal of cases. Moreover, the Banking Tribunals need increased logistical support, modern office equipment, and trained support staff. To finance improvements to the Banking Tribunal infrastructure, a user fee representing a small percentage of the claim filed by lending institutions should be considered as a commercially viable means of funding the necessary material resources required.

Improve Land Titling

A sound land titling system is fundamental to the growth of housing finance in Pakistan. The basis for debt recovery and foreclosure is legal title to land. Currently, uncertainty in land titling and registration makes it very difficult for financial institutions to lend in the housing



sector. A major overhaul of the existing land titling and registration process is needed. A comprehensive study should be conducted under the authority of the Federal Government with the goal to develop one functional land transfer and registration system for the entire country. A functioning system would generate more land revenue, boost the economy in general, and quickly pay for itself.

Reduce Stamp Duties and Registration Fees

The lack of compulsory registration of title documents, the high fees levied under the Registration Act, and the exorbitant rate of stamp duties are primary factors that discourage the proper recording of land transactions. A new land titling system is a necessary long term goal, however, it will require years to implement. Meanwhile, there are opportunities for short term solutions to bring land transactions back into the formal registration system. Clearly, if rates were reasonably reduced, more people would register property transactions. Revenue would be optimized while the current hindrances to financial and economic activity, particularly in the housing sector, would be significantly reduced. Although this is a provincial government issue, the Federal Government must rationalize the current fee structure and assume the initiative for change and the coordination of action with provincial governments for a consistent fee structure for the entire country.

License Property Evaluators

There is no standard system for property evaluation or minimum qualifications for property evaluators. The Institute of Chartered Surveyor's currently have a system of land evaluation. Housing Finance Institutions should work with the Institute to develop a comprehensive system of licensing and regulation.

Limit Adjournments

The Civil Courts and Banking Tribunals are rather liberal in granting adjournments. Under

the law, it is within the purview of the judge to use discretionary judgement when granting adjournments. However, adjournments should be strictly limited in accordance with the law and punitive costs for adjournment should be enforced.

Criminalize Bad Checks

The seminar participants discussed potential criminal penalties for issuing bank drafts on insufficient funds, and unanimously agreed that this would serve as an effective tool to pursue loan defaulters in cases where "bad" checks are involved. The seminar participants were informed that this legislation is currently under advanced stages of review by the Ministry of Finance, and therefore did not propose further action at this time.

Recommendations:

- ***Judicial Determination***
- ***Enforce Decrees***
- ***Increase Court Resources***
- ***Improve Land Titling***
- ***Lower Duties and Fees***
- ***License Evaluators***
- ***Limit Adjournments***
- ***Criminalize Bad Checks***
- ***Limit Court Intervention***
- ***Regulate Developers***
- ***Standardize Forms***
- ***Monitor the Courts***



Limit Court Intervention and Promote Equal Treatment

In Sri Lanka, under the National Housing Act court action in foreclosure cases is not required. If the lender does not receive a response to a series of notices, they can proceed to sell the mortgaged property. After the sale, it takes approximately one month to process court orders to vacate the premises. From the time action is initiated, it takes four to six months to implement a foreclosure.

Similarly, under Section 69 of Pakistan's Transfer of Property Act, a banking company as defined in the Banking Tribunals Ordinance is allowed to sell property without intervention of the court. The Ministry of Finance is currently in the process of amending the act to make it easier for banks to utilize the provisions of Section 69. Housing finance institutions should be treated as banking companies for the purposes of this legislation.

Regulate Housing Developers

A regulatory framework for the development of housing in Pakistan should be implemented. This has been a very successful strategy in Malaysia, where housing developers are required to obtain a license from the appropriate regulatory authority, and are required to keep authorities informed of corporate changes, appoint auditors, and

regularly submit audited reports of their accounts. In turn, regulatory authorities are required to monitor the performance and conduct of developers. Developer accounts are managed by banks or HFC's and prevent potentially unscrupulous developers from misusing mortgage funds by ensuring that all money deposited and withdrawn from the accounts are performed in accordance with the law. Developers found guilty of offenses are prosecuted and if found guilty, are fined and/or imprisoned for up to three years.

Standardize Forms and Procedures

Emerging HFCs should standardize all loan application and processing forms, and standard Sales and Purchase Agreements should be required to safeguard the interests of both home buyers and developers. Computerized application, loan processing and accounting systems provide effective monitoring for rapid follow up to delinquent loans before they become a serious problem.

Monitor the Courts

Banking Courts and Tribunals, like other courts in Pakistan, should be periodically inspected by the Superior Judiciary. In particular, cases that have not been processed within the timeframe established by law should be tracked and monitored closely for resolution.



Appendix A: Agenda

Seminar on Foreclosure and Debt Recovery Laws and Procedures

Karachi, Pakistan

May 9, 1993

- 9:30 Participant registration
- 10:00 Recitation from the Holy Quran
- 10:05 Welcome address by Mr. Askari Taqvi, Chairman, Twenty-First Century Consultancy and Management Services (Pvt) Ltd.
- 10:10 Introductory remarks by Mr. Earl Kessler, Director, USAID Regional Housing and Urban Development Office, Bangkok, Asia
- 10:15 Keynote Address by Justice (Retd) K.M.A. Samdani
- 11:00 Inaugural Address by Chief Justice (Retd) Qadeeruddin Ahmed
- 11:15 Break
- 11:30 Discussion of Issues and formulation of recommendations
- 1:00 Break
- 2:00 Discussion of Issues and formulation of recommendations
- 4:30 Concluding remarks by Justice (Retd) K.M.A. Samdani



Appendix B: List of Participants

Mr. Mumtaz Abdullah Chairman Corporate Law Authority Islamabad	Mr. Basharatullah Advocate Quetta	Mr. Shamshad Hussain Chartered Accountant Karachi
Mr. Khalifa Tahir Ahmed President Quetta Chamber of Commerce and Industry Quetta	Mr. Hafeez-ur-Rahman Butt Chairman Association of Builders and Development Karachi	Mr. Syed Mohammed Hussain Chartered Accountant Karachi
Dr. Ziauddin Ahmed Former Deputy Governor State Bank of Pakistan Karachi	Mr. Rashid Akhtar Chughtal Executive Director State Bank of Pakistan Karachi	Mr. Hidayat Hussain Chairman Banking Tribunal Karachi
Mr. Saleem Ahmed Executive Director (Operations) House Building Finance Corporation Karachi	Mr. M.Q. Fazli Chairman Nadira Novelties Karachi	Mr. Tahammul Hussain Pakistan Industrial Credit and Investment Corporation Ltd. Karachi
Mr. S. Naeem Ahmed Director General Planning National Housing Authority Karachi	Mr. Mohsin Hafeez Resident Vice President Citibank Karachi	Mr. Mohammed Iqbal Senior Vice President Industrial Development Bank of Pakistan Karachi
Mr. Imran Azim Senior Vice President National Investment Trust Karachi	Mr. M. Luqmanul Haq Senior Vice President Pakistan Industrial Credit and Investment Corporation Ltd. Karachi	Mr. Syed Nasir Hussain Jafri Advocate Karachi
Mr. Irfan Aziz Director National Housing Finance Company (Ltd) Lahore	Mr. Syed Mazharul Haq Senior Vice President Legal Division United Bank Ltd. Karachi	Mr. Kairas Kabraji Advocate SurrIDGE & Beecheno Karachi
Mr. Mahmudul Aziz Managing Editor United Press of Pakistan Karachi	Mr. S.B. Hasan Editor Investment and Marketing Karachi	Mr. Rauf B. Kadri Vice Chairman Inter Fund Housing Finance Co., Ltd. Karachi



Mr. Shahzad Kazi Resident Vice President Citibank Karachi	Mr. Masood Representative Empire Housing Corporation Islamabad	Mr. Shujauddin Qureshi Representative Associated Press of Pakistan Karachi
Mr. Shaukat Kazmi Consultant Pakistan Institute of Development Economics Islamabad	Mr. Mohammad Bashir Jan Mohammed Former President Karachi Stock Exchange Karachi	Mr. Marc Rachman Chief of Operations International Housing Finance Ltd. Karachi
Mr. Masrur Hasan Khan Former Secretary Government of Pakistan Karachi	Mr. Qaiser Mufti Chief Executive Paramount Investment Ltd. Karachi	Mr. Habibur Rehman Bar-at-Law Karachi
Mr. Khan Bahadur Khan Advocate Peshawar	Mr. Hasan Mustafa Managing Director Indus Bank Ltd. Karachi	Dr. Khawaja Amjad Saeed Director Institute of Business Administration University of Punjab Lahore
Mr. Nawaz Khan Director Finance Olympic Estate Finance Corporation Lahore	Mr. Firdaus Naqvi Managing Director Noble (Pvt) Ltd. Karachi	Mr. Justice (Retd.) K.M.A. Samdani Solicitor and Advocate Lahore
Mr. Mansoor Ahmed Khan Advocate Karachi	Mr. Ahmed Niaz Former Commissioner Income Tax Consultant Karachi	Mr. A.P. Sanyal Chairman Rimpa (pvt) Ltd. Karachi
Mr. Amanullah Khan President Islamabad Stock Exchange Islamabad	Mr. R.K. Pasha Director Jaffer Brothers Housing Finance Co., Ltd. Karachi	Mr. Salman Shah Associate Dean Executive Development Centre, Graduate School of Business Administration Lahore
Mr. Azizuddin Khan Executive Vice President Law Division Muslim Commercial Bank Karachi	Mr. Haroon Pervaiz Vice President Legal Department Allied Bank of Pakistan Karachi	Mr. Nazar Abbas Siddiqui Additional Secretary Ministry of Industries Islamabad



Mr. Hamid H. Siddiqui
Executive Vice President
Litigation Division
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Mr. Kamran Siddiqui
Citibank
Karachi

Mr. Jamil Siddiqui
Representative
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Karachi

Mr. Shaikh Suleman
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Jaffer Brothers
Housing Finance Co., Ltd.
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Mr. Fazle Azim Tiwana
Atlas Bot Investment
Bank Ltd.
Karachi

Mr. Amjad Virk
Joint Secretary
Ministry of Finance
Islamabad

Dr. Yousuf
Senior Executive
Vice President
National Development
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Mr. Abid Ali Zaidi
Former President
Association of Builders
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Mr. Yameen Zuderi
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Appendix C: Reporting Cable

R 190710Z MAY 93

FM AMEMBASSY ISLAMABAD

TO AMEMBASSY ABIDJAN

AMEMBASSY CAIRO

AMEMBASSY COLOMBO

AMEMBASSY DHAKA

AMEMBASSY GUATEMALA

AMEMBASSY HARARE

AMEMBASSY JAKARTA

AMEMBASSY KATHIMANDU

AMEMBASSY KINGSTON

AMEMBASSY LISBON

AMEMBASSY MANILA

AMEMBASSY NAIROBI

AMEMBASSY NEW DELHI

AMEMBASSY PANAMA

AMEMBASSY RABAT

AMEMBASSY TEGUCIGALPA

AMEMBASSY TUNIS

UNCLAS ISLAMABAD 06657

AIDAC

FOR RHUDDOS, USAID REPS AND
MISSION DIRECTOR, MISSION HOUSING
ADVISORS, PRF/H JIM STEIN

E.O 12356 N/A

SUBJECT: NATIONAL SEMINAR ON
FORECLOSURE AND DEBT RECOVERY
LAWS AND PROCEDURES

1. PURPOSE. THE PURPOSE OF THIS
CABLE IS TO INFORM YOU ABOUT A
NATIONAL SEMINAR ON FORECLOSURE
AND DEBT RECOVERY LAWS AND
PROCEDURES, HELD IN KARACHI,
PAKISTAN, ON MAY 9 1993.

2. BACKGROUND. THE SHELTER
RESOURCE MOBILIZATION PROGRAM
(SRMP) OF AID/PAKISTAN IS ASSISTING
PAKISTAN TO ESTABLISH A
MARKET-ORIENTED HOUSING FINANCE
SYSTEM. UNDER THE SRMP, PRIVATE
FIRMS ARE ESTABLISHING MORTGAGE
LENDING OPERATIONS. TO SUCCEED,
THESE FIRMS NEED A LEGAL AND
POLICY ENVIRONMENT THAT
FACILITATES GROWTH AND PROMOTES
INTEGRITY. THE PURPOSE OF THE
SEMINAR WAS TO PROMOTE GREATER
UNDERSTANDING OF THE
CONSTRAINTS POSED BY PAKISTAN'S
LAWS AND LEGAL PROCEDURES IN
REGARD TO DEBT RECOVERY, AND
PARTICULARLY TO FORECLOSURE.
FORECLOSURE CASES IN PAKISTAN
FREQUENTLY TAKE MORE THAN 10
YEARS TO RESOLVE IN THE CIVIL
COURTS, AND SPECIALIZED BANKING
TRIBUNALS, WHICH CAN PROVIDE
RAPID DECISIONS, LACK THE
AUTHORITY TO EXECUTE THEIR
DECREES.

3. THE EVENT. THIS ONE-DAY
SEMINAR WAS DEVELOPED TO
PROMOTE AGREEMENT AMONG
POLICY-MAKERS ON ACTIONS TO BE
TAKEN TO IMPROVE THE LEGAL
ENVIRONMENT FOR MORTGAGE
LENDERS. SIXTY PARTICIPANTS
REPRESENTING THE LEGAL,
GOVERNMENT, AND FINANCIAL
SECTORS, INCLUDING HOUSING
FINANCE COMPANIES AND
COMMERCIAL BANKS, ATTENDED. THE



SEMINAR WAS CHAIRED BY JUSTICE (RTD.) K.M.A. SAMDANI, A LEADING FIGURE IN PAKISTAN'S LEGAL ESTABLISHMENT. NOTABLE SPEAKERS INCLUDED MIAN MUMTAZ ABDULLAH, CHAIRMAN OF THE CORPORATE LAW AUTHORITY, KHAWAJA AMJAD SAEED, DEAN OF THE FACULTY OF ARTS OF PUNJAB UNIVERSITY, HIDAYAT HUSSAIN, CHAIRMAN OF THE KARACHI BANKING TRIBUNAL, AND MAJID SULTAN KHAWAJA, CHAIRMAN OF THE FEDERAL CHAMBER OF COMMERCE. ALL THE SPEAKERS EMPHASIZED THE NEED FOR IMPROVED MANAGEMENT OF THE LEGAL SYSTEM.

THERE WAS GENERAL AGREEMENT THAT HISTORICAL EXPERIENCE HAS JUSTIFIED LENDER CONCERNS IN REGARD TO THE ABILITY AND WILL OF THE LEGAL SYSTEM TO ULTIMATELY SUPPORT LEGITIMATE CLAIMS ON MORTGAGED PROPERTY. THE PARTICIPANTS AGREED THAT PARTICULAR ATTENTION NEEDED TO BE GIVEN TO ENSURING THE PROMPT EXECUTION OF COURT AND BANKING TRIBUNAL DECREES, IMPROVING THE

LEVEL OF SUPPORT PROVIDED TO THE BANKING TRIBUNAL, INFRASTRUCTURE, AND REVISION OF PAKISTAN'S INADEQUATE LAND TITLING AND REGISTRATION SYSTEM. AT THE CLOSE OF THE SEMINAR, A DRAFTING COMMITTEE WAS FORMED TO FINALIZE THE SEMINAR FINDINGS AND RECOMMENDATIONS, WHICH WILL BE SUBMITTED TO THE LAW COMMISSION OF PAKISTAN FOR REVIEW AND ACTION. AS PREPARATION FOR THE SEMINAR, THE SRMP PRODUCED A REPORT DESCRIBING THE LEGAL ENVIRONMENT FOR HOUSING FINANCE IN PAKISTAN. THE REPORT, TITLED A "NO COMFORT," IS BEING REVISED TO INCLUDE THE SEMINAR FINDINGS AND RECOMMENDATIONS. TO REQUEST A COPY OF THE REPORT OR FOR FURTHER INFORMATION ON THIS TOPIC, PLEASE CONTACT RANDALL C. CUMMINGS, CHIEF, OFFICE OF PRIVATE ENTERPRISE AND ENERGY, AID/PAKISTAN, OR JON WEGGE, CHIEF TECHNICAL ADVISOR, SRMP, OPEN. AID/PAKISTAN.



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