



USAID | **BOSNIA-HERZEGOVINA**
FROM THE AMERICAN PEOPLE

SECURED TRANSACTION SURVEY ANALYSIS

USAID FOSTERING AN INVESTMENT AND LENDER-FRIENDLY
ENVIRONMENT (FILE)

Contract #PCE-I-00-98-00015-00, Task Order #821 of the GBTI IQC

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Introduction

Pursuant to Section VI(A) of Task Order Number 821 (“Task Order”) and the workplan covering the same period, the USAID-sponsored “Fostering an Investment and Lender-Friendly Environment” (“FILE”) project has prepared this baseline study concerning the litigation and enforcement of secured transaction (collateral law) cases by the courts of Bosnia and Herzegovina (BiH).

It is generally agreed that the absence of an effective collateral law regime impedes creditor’s confidence in lending. A collateral law regime necessarily includes not only the extension of credit, but the ability to enforce credit contracts once they have been made. In this regard, USAID requested the baseline study to gain a better understanding of the effectiveness of the courts in enforcement transactions involving real (immovable) and personal (movable) property.

The baseline study is made up of the following sections:

Secured Transaction Survey Analysis
Survey Data Charts
Database
List of Participating Banks
Bank Solicitation Package

We believe this information provides a full understanding of the data collected and how it was collected, as well as an understanding of the current status of secured transaction litigation and enforcement in BiH.

Requested Information and Task Order Modification

The language of the Task Order provides as follows:

- Conduct a baseline study and produce baseline data, by Entity, on:
 - Number of cases pending in the courts dealing with secured transactions (broken down between movables and immovables)
 - Number of cases filed each year in the courts dealing with secured transactions (broken down between movables and immovables)
 - Number of cases finally adjudicated each year dealing with secured transactions (broken down between movables and immovables).

The results of the study will enable the setting of tangible results in subsequent work plans.

- Conduct a baseline study and produce baseline data, by Entity, on:

- Number of cases pending in the courts dealing with enforcement of judgments in cases dealing [with] secured transactions (broken down between movables and immovables)
- Number of cases filed each year in the courts dealing with enforcement of judgments in cases dealing with secured transactions (broken down between movables and immovables)
- Number of cases finally adjudicated each year dealing with enforcement of judgments in cases dealing with secured transaction (broken down between movables and immovables)
- Length of time it takes to adjudicate a case dealing with secured transactions (broken down between movable and immovables)
- Length of time its takes to collect on a judgment dealing with secured transactions (broken down between movables and immovables)

The results of the study will enable the setting of tangible results in subsequent work plans.

Before undertaking the actual collection of data, FILE considered several options on how best to approach the task, in light of available resources. As the usefulness of the data would depend on the completeness and accuracy of the information, FILE needed a data collection method that would provide the highest quality data within the prescribed time constraints of the Task Order. FILE representatives discussed the various options with several Court Presidents, other donor projects involved in judicial reform, the Ministries of Justice and USAID. All parties agreed that the collection of data from the courts would be a monumental undertaking. And, as discussed below, because each case would need to be manually counted, the limitations on time became a major concern.

The courts do not track collateral cases separately, as they do bankruptcy and criminal cases. The court registries provide a column reflecting foreclosure on real or personal property, but it does not indicate whether the basis of the action is a secured transaction or the taking of property in satisfaction of a monetary judgment or due to judicial enforcement (See discussion below.) In light of the limited number of operating land registries in BiH, and the absence of a pledge registry, there was little need for the courts to maintain this type of information. Further, in as much as the respective Ministries of Justice did not require the courts to report this information, the courts simply did not enter this information into the court registries.

As a separate but related matter, courts assign a new case number for each stage of the litigation and enforcement process in order to present the highest number of cases for annual funding purposes. For example, when a court issues a ruling, the case is closed. If the ruling is appealed, the appeal is given a different number from the underlying case which is considered closed. If and when the case is remanded to the lower court for reconsideration, the case receives yet another case number. As such, a typical case involving a ruling on the original claim, an appeal, a remand back to the first instance court, the issuance of a second decision, and a second appeal, will have five separate file numbers.

Accordingly, an accurate determination of the number of secured transaction cases filed, considered, resolved and enforced in both Entities would require a manual review of each enforcement file in every court (both pending and archived), as well as a follow-up examination of each civil court case resulting in the enforcement against real or personal property. As in illustration of the magnitude of the task, the Sarajevo Court estimates a minimum of number of 60,000 cases that would need to be reviewed, in one court alone. Estimating a need for a minimum of 4 minutes per each file reviewed the project would take 33 days to research just the Sarajevo court. As such, the collection of data from the courts was not a viable option.

FILE next solicited the Ministry of Justice for assistance in collecting the data. Unfortunately, the Ministry no longer maintains this type of information, and was unable to assist in these efforts.

As USAID was interested in information on the processing of secured transactions, FILE evaluated the possibility of collecting information from commercial banks. Typically, in emerging market economies, commercial banks extend 90% of the outstanding credit. As such, in the majority of secured transaction cases, commercial banks are the most likely the plaintiff. It was agreed that information maintained by the banks would present a more accurate picture of the collateral law regime in BiH, as they maintain information on filed cases under the same number from beginning to end. Further, the bank would be able to distinguish between secured transactions and the enforcement of judgments, which the courts were not able to do.

At a meeting held in November 2003, FILE and USAID representatives discussed all these data gathering challenges. As a result of these discussions, the USAID representatives responsible for the FILE project agreed to modify the terms of the Task Order and limit the information requested to data maintained by the commercial banks operating in the two Entities.

Information Solicited

Pursuant to the terms of the modified Task Order, the baseline survey needed to reflect the number of “secured transaction” cases filed in each entity by commercial banks, and the average amount of time it takes to resolve these cases. The specific parameters of these requests are discussed below.

Secured Transactions

The term “secured transaction,” as commonly used, implies a financial transaction whereby a lender agrees to advance funds in exchange for a “security interest” in the real (immovable) or personal (movable) property of the borrower. Accordingly, if and when the borrower defaults on the loan, typically by failing to make required payments, the lender may “foreclose” or take legal ownership of property used as “security,” also

known as “collateral”. The collateral is then sold and the proceeds used to pay the creditor.

As such, the term “secured transaction” necessarily implies a transaction whereby the lender and borrower voluntarily agree to use certain property as security for a loan. This voluntary arrangement differs significantly from the situation whereby one party obtains an interest in the property of another, not by agreement, but by operation of law. This latter situation, sometime referred to as a “lien,” is not based on the mutual agreement of the parties, and therefore differs significantly from a secured transaction, both in the legal and business perspective.

In this regard, the collection of data needed to be sufficiently detail to avoid the confusion between secured transactions and the enforcement of a monetary judgment.

Litigation and Enforcement

The Task Order also requested data on the number of cases involving secured transactions cases pending in the courts, the number of cases filed each year, and the number of cases resolved each year. In BiH, the resolution of a secured transaction case can require two separate proceedings: “litigation” and “enforcement”. Litigation involves the resolution of the underlying claim, while enforcement involves the enforcement of the claim. For example, cases that raise questions regarding faulty registration of interest would need to be litigated in the civil court. Favorable litigation decisions are then submitted to the enforcement court for execution. However, enforcement actions initiated on the basis of certain types of documents, known as “enforceable documents,” skip the litigation process and are filed directly with the enforcement court. This latter process, whereby the court oversees the foreclosure against property, reflects the time to “collect on the judgment” as requested by the Task Order. The number of cases pending includes both the cases filed for litigation and enforcement.

Movables, Immovables and Others

The Task Order requests that the information be broken down between “movables,” including personal property, equipment, inventory, etc., and “immovables,” including raw land, factory buildings, business building apartments, homes, etc. Although FILE limited its request for information to cases involving loans secured by movable and immovable property, several banks furnished information on loan secured by “other” items. Follow-up investigation revealed that “other” included personal guarantees, and more often an unsecured loan. Due to the large number of loans that fell into the “other” category, FILE decided to include this information in the survey database. We believe it helps to provide a more complete picture of the operations of the courts.

Preliminary Data Collection Efforts

Pursuant to the terms of the original Task Order, FILE commenced efforts to obtain information on secured transactions in early October 2003. As noted above, FILE representatives first considered collecting information from the courts, but at the Task Order was modified and our attention turned to commercial banks.

Data Collected From Commercial Banks and Business Finance

Data Maintained by Commercial Banks

The FILE project approached the legal departments of each of the 37 commercial banks currently operating in BiH. We were assisted in this effort by a letter from the Banking Agency of both the Federation of BiH (Federation) and the Republika Srpska (RS). Of the 37 banks contacted, 30 provided the requested information. The data ranged from poor (incomplete) to good (complete or almost complete). To the extent possible, follow-up phone calls were made to rehabilitate incomplete data. For processing purposes, when only a month and year were provided, FILE inserted the first day of the month. As only a few banks included information dating before the year 2000, all data concerning litigation and/or enforcement commenced prior to this date were deleted from the database. At the end, the survey data contained information on 1,366 instances of legal action.

Data Maintained by Business Finance

FILE was also provided access to the legal files of the USAID sponsored Business Finance Project (BF). Over a period of 8 years, BF loaned over \$250 million to the citizens of BiH. A number of these loans required enforcement action against movable and immovable property taken as security for these loans. The BF data is presented separately from the information provided by banks. The separation was deemed necessary due to the fact that BF was not a bank, and operated under different enforcement rules. Of particular note is the fact that USAID would not allow BF to purchase or otherwise “take back” property used as collateral. This mandate could operate to increase the time it takes to enforce a security interest. As many banks take back property as a means of settling with a borrower, it would not be appropriate to include the BF data in with the data from the banks, but it is included for comparison purposes. Accordingly the following information on BF cases is included in a separate chart:

- The number of cases filed by BF and currently pending in the courts dealing with enforcement of judgments in cases dealing with secured transactions;
- The number of cases filed by BF each year dealing with enforcement of judgments;
- The number of cases finally adjudicated each year dealing with the enforcement of judgments in cases dealing with secured transactions;
- The length of time it takes to adjudicate a case dealing with secured transactions.

Data Analysis

The data received from the commercial banks and BF provides some interesting insights into the current state of the collateral law regime in BiH. While there are small indications that the court may be improving in some areas, these gains are tempered by indications of apparent decreases in efficiencies. FILE would not presume to interpret this information for USAID, but our basic observations are set forth below.

Federation

When considering the total number of secured transaction cases filed, which includes loans secured by immovable property, movable property, and “other”, we see both positive and negative trends. If we disregard the data from year 2003 as being too recent and examine only the data from years 2000, 2001 and 2002, there appears to be a notable improvement in the adjudication of litigation cases, and a deterioration in the efficiency of adjudicating enforcement cases.

Percentage Of All Cases

Unresolved	Year	<u>2000</u>	<u>2001</u>	<u>2002</u>
Litigation Cases		84%	82%	72%
Enforcement Cases		82%	86%	94%

But a closer analysis of this data reveals some interesting points. First, the improvement in the processing of litigation cases appears to be due solely to the courts handling of cases involving unsecured loans or loans secured with personal guarantees, reflected as “other” in the survey charts.

Specifically, the data revealed:

Resolved

Litigation Cases	Year	<u>2000</u>	<u>2001</u>	<u>2002</u>
Movable		0%	0%	0%
Immovable		0%	0%	0%
Other		29%	36%	42%

As such, there has been little or no improvement in the courts adjudication of secured transaction cases in litigation.

In the enforcement area, however, even though there appears to be a decrease in overall efficiency, as reflected in the chart below, there is some improvement in the handling of cases involving both movable and immovable property.

Average

Resolution Months	Year	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Movable		N/A	23	8	6
Immovable		10	17	10	5

Granted, the number of resolved cases involving movable and immovable property is small, but the time it took to adjudicate those few cases have improved significantly.

It is also interesting to note that the number of secured transaction cases continues to increase. This seems to indicate that banks appear to be willing to lend on the security of immovable and movable property. But the limited number of resolved cases indicates a failure by the courts to effectively and timely adjudicate these cases.

RS

It is difficult to detect any trends in the survey data for the RS. Similar to the Federation courts, there appears to be some improvement and some deterioration in the processing of these cases. Although the number of cases filed in the RS is significantly less than the number of cases filed in the Federation, in some years the RS has outperformed the Federation in the percentage of litigation cases resolved.

Resolved Litigation Cases	Year	<u>2000</u>	<u>2001</u>	<u>2002</u>
Federation		84%	82%	72%
RS		75%	70%	87%

As with the Federation, the amount of success the courts have in the resolution of secured transaction cases is due in large part to the cases involving collateral other than movable and/or immovable property, but the RS courts have enjoyed some success in the litigation of cases involving immovables which for years 2001 and 2002 were 45% and 50%. Granted, the courts in the RS receive a third of the cases filed in the Federation, but this statistic is worth noting none the less.

We would also like to note that the RS courts have shown a decrease in the percentages of all enforcement cases filed, but some unexpected success in the resolution of cases involving movables. The cases filed in years 2001 and 2002 were adjudicated in 3 and 5 months, respectively. Unfortunately, the RS courts did not enjoy the same success in enforcement cases dealing with real property, as it did in litigation cases dealing with movable property. The percentage of cases resolved during 2000, 2001 and 2002 was a mere 7%, 2%, and 6%, respectively.

Movable and Immovable Property

Without question, the courts in both the Federation and the RS have difficulty with cases involving movable and immovable property. Of the 157 litigation cases involving movable and immovable property filed in the Federation between 2000 and 2003, none have been successfully resolved. Of the 380 enforcement cases files during the same period, only a handful have been resolved. As noted previously, however, the resolution of those movables cases in 2001 and 2002 were accomplished relatively quickly compared to 2000.

It is also interesting to note that, despite the difficulties in pursuing claims against movables, the number of cases filed in both the Federation and the RS has remained high. In year 2000, the number of enforcement filings against movables totaled 60 cases, three times the total number from year 2001 and 2000. Similarly, the number of cases filed in the RS in 2003 increased from 5 in 2002 to 18 cases. This tends to support the idea that banks in both the Federation and the RS are lending on the security of movables and immovables. It is troubling, however, that these loans have ended-up in the courts.

Unsecured Loans and Personal Guarantees “Other”

The category of “other” reflected all types of security which is not immovable property, and which is not readily thought of as movables. Generally, it includes personal guarantees and financial instruments. It appears that the vast majority of loans made in BiH are made on the security of personal guarantees. The banking community’s confidence in this arrangement appears to be supported by the survey data. Of the total number of 562 cases filed against “other” forms of collateral filed in all three entities, a total of 122 have been resolved. This equates to a 22% resolution rate, by far the highest compared to cases involving movables and immovables.

Conclusion

Clearly, before the economic environment in BiH can become more attractive to domestic and foreign investors and lending, the courts must be able to process and resolve all types of collateral cases more effectively and efficiently. The statistics involving movable and immovable property are discouraging in both the number of cases resolved and the time of resolution. Intensive training of judges, which makes them more confident in resolving these types of cases, as well as the implementation of the pledge and land registries, should result in dramatic improvement in these figures.