

Implementing a Secured Transactions Framework in Peru: Utilizing the Tools of Policy Based Lending

Chronology of Key Events

Inclusion as a condition in Financial Sector Reform Program II (a Policy Based Loan approved August 1999)

- Diagnosis done by CEAL in 1998 & early 1999. Findings confirmed the importance of moveable property (60 – 90% of capital stock – small producers at upper range)
- Original loan condition (as stated in Profile I -- Jan 1999)
 - o First tranche: Start drafting law
 - o Second tranche: Present law to Congress, regulations drafted, start setting up registry
- Modified loan condition (as stated in Profile II -- May 1999):
 - o No first tranche condition
 - o Second tranche: Initiate drafting of law
- Final loan condition (as stated in Policy Matrix of Loan Proposal -- August 1999)
 - o First tranche: prepare a workshop to identify issues and draft action plan to overcome impediments to use of moveable property as collateral for loans.
 - o Second tranche: Workshop complete and implementation initiated of agreed action plan
- Reasons for weakening of the condition
 - o Focus of FSRP II was on financial crisis management. Moveable property initiative was part of a subsidiary effort to improve climate for micro finance.
 - o Banking community and friends in counterpart agency (Ministry of Economy and Finance -- MEF) did not understand the idea very well and did not like what little they understood.
- Program execution experience
 - o Great time pressure for tranche releases: First tranche on Dec. 6 1999. Second tranche on Dec13, 1999
 - o Waiver on completion of workshop had to be granted

Developments following the FSRP II

- Workshops based on the draft consultant report were carried out in August 2000.
 - o Meetings held with all major private-sector stakeholder groups: Colegio de Abogados de Lima, Camara Nal. Forestal, Assoc. Empresarios Agrarios, Camaras de Comercio, Asociacion de Exportadores (ADEX), Bolsa de Valores, Asoc. de Bancos, etc. Strong positive response with groups identifying how moveable property guarantees could benefit their particular businesses.

- MEF invited to all workshop meetings but shows minimal interest.
- Consultant's (CEAL) final report distributed and ultimately published by local university (UPC) in December 2000¹
- Colegio de Abogados de Lima endorses consultant report main recommendations for legal reform in January 2001. (In retrospect this was probably a turning point in the local attitudes about the issue.)
- MEF forms public-private Commission to review issue in June 2001
- MEF Cabinet of Advisors releases "White Paper" restating all major criticisms of current system and proposing legal reforms and creation of unified registry in July 2001
- SBS releases quantitative study of costs and time delays of traditional guarantee system in February 2002
 - Time required to execute guarantees for loans above \pm US\$6,000 is 31 months
 - Raises the effective cost to bank of granting credit by around 2%
- MEF sets up a public-private Commission to draft a *Proyecto Ley de Garantía Mobiliaria* which releases first draft in March 2003

Preparation for Competitiveness Reform Program PBL & reentry of IDB into consensus building process:

- Multi-sector reform program including financial sector reform elements agreed with GoP in late 2002
- Foro Nacional de Competitividad held February 2003:
 - Nine *mesas de trabajo* including one on finance which stresses importance of (i) MEFs commission on guarantees, (ii) allowing for extrajudicial execution of guarantees, and (iii) the creation of specialized courts for resolution of commercial disputes.
- Consultants hired to critique first draft of Law.²
- Inclusion of policy condition on Moveable Property Guarantees in new Competitiveness Reform Program, a PBL. to be presented for Board approval in November 2003.
 - First tranche, Dec. 2003: Presentation to Congress of satisfactory draft law taking into account all major recommendations of consultant critique (except for extension to fixed assets)

¹ *Trabas Legales al Crédito en el Perú: Garantías Mobiliarias*

² Major criticisms made in consultant review. The draft law should be modified to allow for:

1. financing of accounts receivable and similar portfolios.
2. extra-judicial execution of guarantees
3. a mechanism for transition from existing multiple guarantee registries to single registry
4. exemption of guarantor from the process of asset restructuring in the case of bankruptcy
5. guarantees on fixed assets (e.g. real estate)
6. using a pool of mortgages as a guarantee
7. taking into account international law on private property rights
8. hybrid or simulated guarantees to forestall prior claims by hidden creditors
9. a complete listing of all changes to existing laws needed to assure the effectiveness of the new law.

- Second tranche, mid 2005: Moveable property law in effect, property registry operational, and all regulations etc. necessary for its functioning approved.
- The PBL also includes initiatives to create specialized commercial courts and reforms to system of (extra-judicial) binding arbitration
 - PBL sponsored efforts are being coordinated with a USAID project to provide Technical Assistance for judicial reform in general.

Challenges for the future

- MEF needs to work with congressional committees to make sure these key features remain intact during legislative review and approval.
 - Second tranche condition of PBL provides one incentive.
- Development of central registry
 - Notaries plus others will be allowed to register properties
 - Broad access to records via internet based examination.
 - Decision to go with the government agency (SUNARP) responsible for property registries instead of a private registry
 - Technical assistance will be provided for SUNARP
- Expected situation at end of PBL
 - Second tranche conditionality fulfilled
 - “Outcome Indicators” of development effectiveness.
 - System established and demonstrating reductions in time and cost of execution of guarantees (may use the SBS methodology)