PANEL #3: LOCAL AND INTERNATIONAL CREDIT AND SECURED LENDING TRANSACTIONS FOR BUSINESS ENTITIES

What are the implications for economic development from a secured lending transactions point of view for small and medium-sized businesses in Latin America? This panel—composed of some of the world's leading experts on trade and lending—will look at what drives or impedes such lending practices from different rule of law perspectives, including:

1. Substantive rules that are largely made by the parties and are contrary to the traditional legislative restrictions on open ended availability of contractual and in rem rights;
2. Reliance on a functional as opposed to a purely formal notification system to creditors and third parties;
3. Reliance on remedies derived from contractual stipulations.

At first sight, these legal institutions would seem contrary to traditional principles of the rule of law where only the legislature can create in rem rights or only the judiciary can rescind contracts and provide remedies. In this connection, the Panel will discuss the new economic development-inspired meaning of separation of powers of constitutional concepts such as due process of law.

PANELISTS

Dr. Boris Kozolchyk, President and Director, National Law Center for Inter-American Free Trade

Licenciado Marco Bográn, Deputy Director and Legal Counsel, Millennium Challenge Account (Honduras)

Licenciada María del Pilar Bonilla, Partner, Bonilla, Montano, Toriello & Barrios

Mr. Nicholas Klissas, Esq., Legal Counsel, United States Agency for International Development (USAID)

Mr. Adolfo Rouillón, Esq., Senior Counsel of Finance, Private Sector & Infrastructure Legal Department, The World Bank

DRA. MACARENA TAMAYO-CALABRESE:[1] Well then, good afternoon again. We are going to begin the afternoon session.

We will start with the following panel, the third in the series, which is entitled "Investing in the Future: Local and International Credit and Secure Lending Transactions for Business Entities." This panel purports to examine the implications of economic development in Latin America from the perspective of secure transactions and small loans for small to medium-sized businesses. Joining us is our Chair, Dr. Boris Kozolchyk, whom you already know.

Next, I will introduce our panelists. We have with us Licenciado Marco Bográn, who is the Deputy Director and Legal Counsel of the Millennium Challenge Account in Honduras. He received his law degree from the Universidad Nacional Independiente in Honduras and an LLM in Corporate Law from the Universidad Tecnológica of América Central. Welcome.

We also have Licenciada (Lic.) María del Pilar Bonilla, partner at Bonilla, Montano, Torriello y Barrios. Born in Guatemala, Lic. Bonilla studied at the Universidad de Francisco Marroquín in Guatemala and received her Master's Degree from the Universidad Autónoma in Barcelona, Spain. She is also a law professor at the Francisco Marroquín School of Law and at the Universidad Rafael Landívar. Again, welcome.

We also have Mr. Nicholas Klissas, who is the Chief Legal Counsel for the United States Agency for International Development (USAID). Mr. Klissas advises on international business reform in USAID's Economic Growth, Agriculture and Trade Bureau. There, he works on projects related with corporate law and its facilitation towards global commerce. Welcome.

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1. Director, Latin America & Caribbean ABA Rule of Law Initiative.

Finally, we have Mr. Adolfo Rouillón, an attorney in the World Bank's Public-Private Partnerships in Infrastructure Program (PPPI). He has written seven bankruptcy books and more than 150 articles about corporate bankruptcy law. His publications can be found online and in legal journals in Argentina, Ecuador, Venezuela, Italy, Spain, the United Kingdom, and, finally, the United States. Welcome. With that out of the way, we will begin the third panel.

DR. BORIS KOZOLCHYK: Thank you again, Macarena. I will be the Chair of this panel and, as the Chair, will briefly, perhaps five minutes or so, introduce our topic and its economic and legal significance. Further, I will say a few words about the panel's structure and how it will operate. Before we begin, I would like to draw your attention to a very distinguished Mexican jurist, Magistrado Juan Luis González Alcántar. Please, Juan Luis. Among other reasons, Magistrado González Alcántara is with us because he is part of a working group that is considering revision of Mexican private property law. Judge González Alcántara also visited our center and left a very positive impression. I am not sure, but I believe Mr. Isaac Veley, who is also a member of the working group, from the Mexican Ministry of the Treasury will also be joining us. I welcome you both.

First of all, regarding the topic, why is it important? I am going to talk briefly about its economic significance. A few years ago, World Bank studies indicated that between ten and fifteen percent of a country's GDP was linked to the presence or absence of secured transaction laws allowing for self-liquidating security structures used to finance small and medium-sized businesses.

Let me take a moment to explain what I mean by the term auto-liquidation (non-judicial security foreclosure). As an illustration, the government of Brazil determined that approximately thirty to thirty-five percent of the costs associated with business loans are attributable to the costs incurred to recover back the loans. It follows that, if this type of lending uncertainty was reduced or eliminated, the loans available to small and medium-sized businesses would increase. Aside from making more money available to these small and medium-sized businesses, this type of credit, commonly known as "bursatilization," "securitization," or "titling," has been used through out the world, not only in the United States but also in Europe and Latin America; securitization has been greatly responsible for the growth of the

construction sector in Mexico. Securitization, as you will also see, has something in common with security interests; they are both self-liquidating and come from independent and autonomous funds. If you take into consideration the impact of making credit available to the private sector, credit made available to small and large commerce, credit made available to the business and industrial sectors by securitization, you are undoubtedly talking about a genuine revitalization of a country's economy. Therefore, this is a topic that has real links to economic development.

And what relationship does this economic development have to the rule of law? The relationship is multifold, but perhaps the most important is that it is a self-liquidating process (non-judicial security foreclosure). What does that mean and why does the fact that it is a self-liquidating process matter? It matters because whatever is produced or involved as the result of a loan, including purchases, sales, and transformations of primary products, whether they are movable goods or goods from the construction sector, can be used to secure the loan. This type of process allows for the self-liquidation of loans; in other words, the securitization of this property can allow for a non-judicial security foreclosure on non performing debt. As a consequence, additional property is not needed for security; only the involved property that has been pledged or independent funds pledged to pay the debt can be used to satisfy the debt. That is one idea.

I am not sure if President Batlle is still here, but he talked this morning about the impact England had in the Eighteenth and Nineteenth Centuries. Back then, the Bank of England created for the first time a business loan as distinct from a civil loan, a consumer loan, or a traditional mortgage loan. The business loan was distinguishable because it was short-term, it could be renewed from term to term, and the product related to the business loan was used for collateral. This is the conceptual framework of self-liquidation, non-judicial security foreclosure. The Bank of England could create this type of loan because it was at the top of the credit pyramid. At the base of the pyramid was the consumer, who bought from the retailer, who bought from a dealer, who in turn bought from the manufacturer. The manufacturer, for his part, obtained financing from banks. All this paper, all this flow of money was generated at the base of the pyramid from the consumer and flowed up to the Bank of England. This flow of money secured the business loans with representative documents or in kind. What made this cash flow possible was that it moved upwards

(to the top of the pyramid) and then downwards (to the consumers). The credit pyramid model created by England in the Eighteenth Century was amplified in the United States in the Nineteenth and Twentieth Centuries. Today, between fifteen and twenty banks run the banking industry in England. During the 1950s and 1960s there were between fifteen and twenty-thousand banks performing the same functions in the U.S. Thus, the credit pyramid model multiplied enormously and began to take root all over the world. This is what we are seeing nowadays. That is to say, the global credit pyramid is extremely important today, especially if you consider the issue of real estate credit. If one is outside the pyramid, one cannot participate in the market. Conversely, if one is inside the pyramid, one can hope to advance within the market, at least to a regional level.

The rule of law makes sure that self-liquidating guarantees can work, that there is a functional availability of extrajudicial remedies. Take, for instance, a situation where perishable goods are given as collateral for a loan, say cheese, for example. If the cheese is not repossessed immediately, I do not have to tell you what happens. Earlier today, the President of the Peruvian Supreme Court told us that in Perú, it takes between four and six months to repossess collateral through official means. When this is the case, you can forget about using perishable goods as collateral and using this type of collateral. Consequently, if you are talking about using highly perishable goods as collateral, the process for repossessing them has to be flexible and fast, especially in the private sector. In the event the self-liquidation transaction proceeds contrary to the law or there is unjust enrichment, the process also needs to be subject to judicial review. Most important, however, is that we have to follow trade laws that emerged in the Nineteenth Century; namely, that you pay first and then complain. This historical process is analogous to what is currently contemplated for this type of commercial law. Therefore, we have chosen this panel for the following reasons: because today there is a bill pending in the Guatemalan Congress that incorporates for the first time the principle I have just discussed.

We are going to hear from Licenciada Bonilla, who collaborated on this bill. We are also going to hear from Marco Bográn, who has experience with a similar bill in Honduras. In Honduras, however, legislators are embarking on a much more ambitious project that not only contemplates changing the law but also establishing an electronic property recorder registry on a regional level.

The plan also includes a bankruptcy law that incorporates the type of loans we have been discussing, and also a law governing electronic business transactions (e-commerce) that contains various accounting provisions, as well as manuals for training small and medium-sized business owners. The manuals would teach the business owners how to keep their books in a way that would give banks the confidence to loan them capital. We are going to understand this process. Finally, Mr. Adolfo Rouillón will talk to us about the relationship that exists between bankruptcy law and secured transaction laws; as a representative of the World Bank, Mr. Rouillon was responsible for shaping this type of legislation in many countries. The panel will begin with a discussion by distinguished North American lawyer, Nic Klissas, who works for an agency that finances these types of ventures all over the world. Nic will first talk to us about projects his agency has undertaken in certain non-Latin American countries, and afterwards we will continue with Marta and Adolfo, whose discussions will focus on the Latin American region. I am not going to introduce the presenters individually, as this was done earlier. We will simply begin with the first and proceed in order from there. Thank you.

MR. NICHOLAS KLISSAS: Good afternoon, ladies and gentlemen. With my apologies, I'm going to be speaking in English even though the bulk of the conversation taking place today is in Spanish. Again, my apologies. I'd like to thank LexisNexis for inviting me down here, and certainly, Dr. Boris Kozolchyk, and thank you for being here to listen to us today.

My remarks today are my personal remarks that don't really reflect the official position of the U.S. Agency for International Development (USAID). I would just like to talk to you a little bit today about where we stand at USAID, why we're interested in secure transactions, and what our experience has been.

In USAID, we have the mission statement that we want to promote poverty reduction through broad based economic growth. We're now developing a formal economic strategy. This is going to be a roadmap that will be a guiding light, the foundation for us in our programs for the future. Although this economic strategy is still not officially approved, the strategy lays out certain kinds of fundamental concepts, not very controversial, but still maybe worth repeating here. One of these concepts is that economic growth is necessary to reduce

and perhaps, someday in the future, eliminate global poverty. In Latin America this might be somewhat controversial, because people can point here in Latin America to a wide disparity in incomes – wealthy people getting wealthier, the poor getting poorer, and a poverty level that provides a launching point for discussions that takes place and certainly something very politically polarizing. Nonetheless, without economic growth, experience shows that the poor cannot get themselves out of poverty. And if a country can sustain economic growth, say a constant five percent per year over a period of twenty years, such growth could double its annual gross domestic income.

The second economic strategy that we're developing revolves around the fact that that right now, capital flows going into developing countries from donor countries or donor institutions form a minority, a very small minority of the money that is flowing into developing countries, maybe ten percent or twenty percent. It's really the private sector, foreign direct investment from private sources that are funding the bulk of investment in developing countries.

So, what can USAID do? What can the international donor community do to use the resources that we have to best promote transformational development in the world? I just want you to know, transformational development is a term of art that we've also developed in the U.S. government and at USAID. It is a concept that we would like to take developing countries to a certain point where their growth will just take off automatically without any further assistance from USAID, the World Bank, or any other institutions. It would be a point where private investment/financial companies would lend funds without any support from international multilateral institutions.

So, what are the things that we can do to help those countries reach that point, for these countries to be able to access these types of private funds? We've really done a lot of thinking about that, and there's a new framework for U.S. government assistance to developing countries that has been adopted. Again, a lot of changes are going on within the U.S. government. These concepts are just part and parcel of a range of new ideas and new organizations like the Millennium Challenge Corporation, the new Under Secretary of State for Foreign Assistance and a re-organization that's been taking place at my agency.

But, anyway, in this new foreign assistance framework, one thing that we have been highlighting quite a bit is the need for a business-enabling environment where people would comfortably invest in their own countries and feel good about investing in their own

country. This environment would help reduce risk and promote economic growth. So, there's a lot of discourse within the agency about these goals; I should mention, in my agency, we are not an agency that is led by lawyers. In fact, if you take a typical sample of USAID staff, most of them, I think, are probably former Peace Corps volunteers. So, these are people that really want to get out there, help people on the ground, person-to-person, and not necessarily work on projects that deal with things that economists and lawyers necessarily deal with, such as high level issues that are dealt with in parliamentary committees or in the Ministry of Finance or in the Ministry of Economy. It's not as tangible as going out there and helping a farmer, maybe with new seeds or maybe delivering drugs that are needed to suppress the symptoms of HIV/AIDS. But, nonetheless, there's a lot of discourse going into how can we take what little money we have that we promote for business-enabling environment reform and help countries go through such a business transformation.

And so, I'm here today to talk to you about secured transactions. I was speaking earlier with a gentleman about secured transactions and I was mentioning how I consider this a democratization of access to credit around the world. Consider that in any country, you'll find wealthy individuals, corporations that are well-established that have very good access to credit at the top. They are known entities, they might even have their own banks so they have a ready source of funds that they have access to; they're very credit-worthy. And then at the lower end, we certainly are aware of certain programs based on micro-lending, a response towards the democratization of credit. And in fact, I spoke one day—this was back in Washington, D.C.—with a well-known newscaster. His name is John Stossel and he said: "Well, you know, the answer to international development is more micro-lending." Sure, micro-lending is very good, but the typical kind of micro-lending that I'm familiar with is the kind that goes to widows or people in very poor countries where the amount of the loan might be $100 or $150. That's not the sort of lending that will actually enable SMEs, small and medium-size enterprises, to grow and prosper. That kind of micro-lending helps people get out of poverty, it gives them a mean of subsistence or of getting out of a poverty trap, but it doesn't necessarily get a country and its entrepreneurs into that zone where you can accomplish transformational development, where you can realize economic growth.

Secured transactions are a kind of reform that is easy to implement. I say that with maybe a bit of jaundiced eyes but it's a very simple concept and if implemented properly, it is a magic key to unlock credit, to give credit to those SMEs around the world. At this point, I just want to make a footnote over here. A lot of discussion has been said about using real property as a means of access to credit, giving out titles to people that own houses, condominiums, farms, et cetera. The problem that we have found with titling and real property is, first of all, it's very expensive to do. And USAID, as an institution, doesn't typically have sufficient funds to support titling projects in countries around the world. Fortunately, there are institutions like the MCC, the Millennium Challenge Corporation, which, I think, are doing some titling projects in Latin America and other places in the world such as Madagascar. But nonetheless, even when the titling project is finished, the effect on access to credit may be limited. Studies have shown that in places where it has been done, maybe one out of ten households actually utilize their titles as a form of mortgaging so that they can invest it into a business. Certainly, titling has other social ramifications that are very good, but in terms of just getting credit to people so that they can invest in business, it's not as substantial as perhaps we would like to think it is. So, secured transactions using real property as a means of credit access implies a system that can give people ready access to the use of the system and it implies people aware and willing to use this system.

I will run through a couple of countries as examples of projects to promote the structuring of systems for secured transactions. I first worked on countries in Eastern Europe and the former Soviet Union. When I arrived at USAID, I actually inherited projects that other people had set up. USAID first started working in Eastern Europe and the Soviet bloc after the fall of the Berlin wall in 1989 and then after the fall of the Soviet Union in late 1991. The U.S. Congress actually charged us with helping Eastern Europe develop market economies and then, by extension, also the former Soviet bloc. In each of the Eastern European countries and practically every single Soviet-bloc country, when I arrived on the scene in USAID, there was some project going on to develop secured transactions.

And what do secured transactions entail? Maybe I'm just beating a dead horse; maybe you're very familiar with it. But it entails setting up a registry where people can file a claim. It also means making some legislative changes to enable people to pledge collateral.

It also means some refinements in the bankruptcy code. And it also requires some maybe philosophical hurdles that a lot of legal systems have to clear. Certainly, one of the major philosophical hurdles is the ease of enforcement. Secured transaction lending doesn't work if you first have to go to a judge in a court and get some kind of court procedure in motion in order for a creditor to receive what was pledged to him by a debtor. Secured transactions work best when there is no court involvement at all and better still if there is recourse for the debtor to go to the judge if he feels he has been mistreated when dealing with the collateral. Second of all, the less paperwork, the better. Furthermore, a more generalized requirement for collateral statement description, the less the need for identification of specific items used as collateral. This is a preferable feature in a secured lending environment.

There are a couple of country examples that I can talk you about. In Bosnia, we set up a collateral registry, and it was very cheap to set up. It was on the order of $500,000, not very much money. It was also set up specifically so that it could be used very cheaply. Collateral could be registered electronically, and the charge did not exceed ten dollars [U.S.].

Compare the Bosnian collateral registry with Poland's experience, where a collateral registry was also set up; the amount of the charge for setting up the collateral was usually based on a percentage of the value of the item. So you can imagine if it is a major piece of machinery worth several million dollars, you're talking about a major fee to pledge that collateral instead of a simple ten dollar charge. We have found in our experience that keeping the fees low is crucial to the success of secured lending. If the fee is variable, if it requires a lot of people and steps to approve the documentation, if you need notaries, if you need to base the fees as a percentage of the asset, people will not use the system. And then you have defeated the purpose of the system, which is to provide credit to people. It's not meant to be and it should not be viewed as a revenue-generating source for a ministry or a court that might be charged with administration of the system.

In Macedonia, we now have a collateral registry system that's working pretty effectively. I said "pretty effectively" because there have been a lot of hands and maybe a lot of chefs dealing with the soup. In my experience, sometimes it takes about three bites at the apple before you can get a law passed by parliament that works well with all the users and all the people who implement the law. I would

also mention Montenegro. We have a lot of experience in Eastern Europe, as you can tell. Montenegro uses a web-based system. At a recent seminar in Cairo, we actually had a demonstration by one of our USAID staff from Montenegro that showed how the web-based system could be accessed in Cairo, how assets could be pledged even in Cairo, and how inexpensive it was to use.

Lastly, I should mention that in Latin America we have been supporting the efforts of Dr. Boris Kozolchyk, who is attempting to implement a harmonized system of collateral lending in the Central American countries. As you all know, free trade agreements hold the promise of enhanced economic growth through greater trade in economies. But what USAID was most interested in, besides helping implement the free trade agreement was how to help the countries in Central America better take advantage of what the free trade agreement could provide. In African countries, we found, and this is an extreme example, but we found that once you reduce tariffs to zero, there are still internal barriers to trade in African countries that amount to about three times of whatever a typical tariff barrier would be. We found that in many countries, there are many roadblocks, literal roadblocks where there might be a policeman extracting bribes for transporting goods to the border, maybe there are people at the customs office or in other places which hold up the shipment of goods to extract some kind of concessions from the people that are trying to export or import.

So, again, back to why we were helping Central America. We wanted to make sure that the Central American countries and our partners are doing all they can do to help make their own companies more competitive in order to reap higher prices on the international market. Secured transactions accomplish this by reducing internal interest rates by ensuring a steady source of credit and also by expanding the group of people that have access to credit. Like I said earlier, the very wealthy, privileged class has access to very big loans from banks. In the other extreme, the very poor cannot get access to micro-lending. In the middle, there exist those small and medium-size enterprises that may not have real property but do have things like assets in a warehouse, inventory, receivables. If they can unlock the capital that's locked up in those things, then they can obtain funding to expand production, maybe start supplying Wal-Mart or Target and move on from there. I think I will leave it there and let the others speak. Thank you very much.

KOZOLCYK: Thank you for having been so forthright. Right on the money.

LIC. MARÍA DEL PILAR BONILLA: Good afternoon. Can everyone hear me? Thank you, Boris. I would like to take this opportunity to thank LexisNexis for inviting me and for the initiative that LexisNexis has taken in sponsoring this symposium.

As Boris mentioned earlier, the Guatemalan Congress is considering a bill that would establish a law for security interests. The bill has been approved by the congress in its first and second reading; the bill needs one more round of voting before it can become law, which is anticipated to happen in the next few weeks. The bill attempted to incorporate the principles underlying the legal model promulgated by the Organization of American States (OAS). As such, we tried to make the law congruent with the legislative guidance provided by the UN Commission on International Trade Law (UNCITRAL).[2]

Realizing that countries that belong to the Roman-Germanic system have a certain way of drafting statutes, our first priority was that the final statute squared with Guatemalan law and with the basic form that laws take in our countries, without losing sight of tenets that should be respected. At the same time, the statute should address the interests and needs of individual countries. For that reason, we take into account that in countries with relatively small economies like Guatemala, small and medium-sized businesses play a very important role in the overall economy. However, the credit available to small businesses especially is very limited in reality. Often, a mortgage was thought to be the only method of guarantee that bank creditors were willing to accept. At the very least, other types of guarantees were

2. The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 (Resolution 2205(XXI) of 17 December 1966). In establishing the Commission, the General Assembly recognized that disparities in national laws governing international trade created obstacles to the flow of trade, and it regarded the Commission as the vehicle by which the United Nations could play a more active role in reducing or removing these obstacles. United Nations Commission on International Trade Law website, http://www.uncitral.org/uncitral/en/about/origin.html.

somewhat marginalized in the legal system since the lack of laws did not promote the instrument and provide certainty; secured credit instruments involved more risk and, consequently, became more costly to use. For this reason, the Central Bank of Guatemala, the Superintendent of Banks, and the Ministry of the Economy, acting in conjunction with the Under Secretary for Small and Medium-Sized Businesses, spearheaded the legal project that resulted in the bill currently making its way through the Guatemalan Congress.

What statutes had to be revised when implementing this type of project? The first statutes that required amending authorized certain kinds of collateral or, more accurately, limited the types of collateral allowed under the Guatemalan civil code. There was only one statute on point and that obviously encompassed traditional collateral or easily identifiable movable goods. Needless to say, the statute did not envision other goods that could be used to secure loans, nor did it protect creditors who accepted such unconventional loan guarantees. Next, the trade law had to be revised in order to make room for credit bonds, liens, and the law of general savings deposits. And finally, certain regulations that allowed for real guarantees, but that did not include protection for creditors or debtors, also required amending. Furthermore, the regulations on the types of recordable goods had to be changed because in Guatemala, the only registry where identifiable movable goods could be recorded was the general property registry. This is not a suitable registry for the publication of secured interests since secured interests have a much wider scope than identifiable real property rights; this registry reflects the traditional civil law nature of property. At the very least, we need a registry that is agile, electronic, easily-accessible, and low-cost but, above all, one in which there is no minimum qualification requirement or one that requires proof of property ownership because it should not have anything to do with real property, but instead should deal with personal property.

The law that created the biggest controversy in the revision process was the section dealing with the methods for processing a claim in relation to the constitution because in order for a security interest law to function properly it should be able to be executed procedurally in a rapid manner in accordance with the ephemeral nature of the interest used to secure the loan. At a minimum, the project aspires to include the possibility that parties agree beforehand to not go to a judicial body to execute the guarantee, and instead abide by the terms and conditions that they freely agreed to in the beginning

and that they were able to tailor to the type of goods or credit used in their particular transaction, be it consumer or commercial credit. Including a voluntary execution of this type, completely outside the reach of judicial bodies, awakened certain controversies, especially constitutional controversies, which were ultimately overcome. Finally, it is important to mention that a statute codifying secured interests should be careful not to tip the scales in either direction. It has been proven that protectionist statutes or those that favor one side are destined to fail. There is no need for a law that protects either the debtor or the creditor. There should be a general law that is easy to understand, with clear and simple principles, which both parties, based on voluntary free will, can rely on a contract with each other. The law should also respect the freedom of contract and, above all, reach out to small and medium-sized business owners, who should see themselves as the primary beneficiaries of this kind of law. Lastly, the law should anticipate the creation of a registry. The registry should be electronic; it should not only strive to create internal, that is to say national, publication, but also the possibility of a registry where international personal property could also be recorded; I am thinking about international documents that are created and easily shared in the global medium in which we live. Thank you.

KOZOLCHYK: Thank you very much.

LIC. MARCO BOGRÁN: Thank you. Good afternoon to you all. I hope that you can all hear okay.

One of the symposium presenters that came before me, Judge Messitte, from Maryland, made a big impression on me with one of his ideas. He talked about how he sees Latin America as a glass that is half-full, not half-empty. I promised him that I would respond definitively to his comment and I want to effectively ratify what he said.

From Honduras, from the National Law Center that Dr. Boris Kozolchyk represents today, to Guatemala, to USAID, and to the World Bank, we are seeing Latin American efforts to make "the law" a vehicle for social development, like the proverbial half-full glass. And we are convinced of this idea. Proof of it exists in what Lic. María del Pilar Bonilla was talking to us today with regard to the bill currently in

the Guatemalan Congress. Similar efforts are being made in Honduras, and probably will be made in Nicaragua and El Salvador because of the fact that those two countries also avail themselves from resources from the Millennium Challenge Corporation,[3] which I represent.

I want to tell you about Honduras and the effort it is making to transform its judicial system in order to reduce poverty through economic growth. This effort is being led by the government, by civil society and we are doing it with the help of international cooperation. For this reason, the presence of Mr. Nicholas Klissas and Judge Messitte is very important for me with regards to this subject matter. But let me continue telling you about our legal project, identical to that occurring in Guatemala, which is based on the legal model promulgated by the OAS in 2002. The effort to pass the legislation and present it to the National Congress has been accomplished with financial support from the Millennium Challenge Corporation, which is an agency run by the U.S. government. Local government participation has been very important, and I believe it will continue to be important for any country that attempts to implement legal initiatives of this type. As Lic. María del Pinar Bonilla mentioned, these initiatives have resulted in radical changes to our judicial systems because our systems up to this point have been closed and have remained faithful to certain constitutional and legal principles that have been around for years and, as a result, are resistant to change.

Nevertheless, in Honduras we have enjoyed the unconditional support of various secretaries of state like the Secretary of Industry and Commerce, which is the equivalent of the Minister of Economy in Guatemala. We have also enjoyed the unconditional support of my esteemed colleague, Ms. María Linda, Esq. and our Supreme Justice Court. In addition, we have counted on the participation of civil society's private sector by way of businessmen, bankers, and chambers of commerce; these last entities are very important because in Honduras, we envision chambers of commerce as the most likely administrators of the security interest registry, which will be created by the new law. The Chamber of Commerce in Tegucigalpa, which is the principal chamber of commerce in my country, obviously based out of the capital, is seen as the administrator of the security interest registry. The Chamber of Commerce in Tegucigalpa has accompanied us throughout the socialization and diffusion processes of getting the bill

3. *See* http://www.mca.gov/.

passed, as well as the "tropicalization" process, which is perhaps the term Lic. María del Pilar Bonilla wanted to use. In reality, these laws have to be "tropicalized," that is, adjusted to fit the judicial system in each country in such a way that the implementation of the laws is really agile.

It is incredibly important, and Dr. Boris Kozolchyk mentioned it at the beginning of his presentation, that the law of security interests in Honduras, as in Guatemala, is considered the starting point for reworking all of our commercial and financial legislation. Until recently, the law has not driven social development, but instead has succeeded in inhibiting private initiative. This is precisely what we want to change. We are certain that, in approving this law, our Congress, our lawyers, and our judicial community in general, understand that our commercial laws need to be transformed and adjusted to the international scene. Accordingly, our businessmen and the investors that arrive in our country will have the ability to compete on equal footing with any other businessman in today's global marketplace.

Guatemala and Honduras are embarking on new paths; in both countries we are certain that the law will be a jumping-off point for amending other laws that are clearly archaic and, on the flip side, design new laws that are necessary for the Central American countries and for the region–and by that I do not just mean Honduras, Guatemala, and Nicaragua, but throughout the entire Central American isthmus. The region needs legislation that will regulate electronic commerce; it needs to revise its legislation pertaining to bankruptcy and for that, the presence of Judge Messitte is especially important on account of those countries using legal orders that do not permit creditors or debtors to effectuate bankruptcies judicially or extra-judicially. The security interests referred to by the Honduran law, which is awaiting final approval, but is likely to be passed, comport with the OAS model from the year 2002. We have confirmed this with the pair of institutions participating in process in Honduras; we have confirmed that the legal model has not been distorted with regard to substantial modifications that could potentially derail our effort. For this reason, the Honduran lawyers that are backing this initiative have become guardians of the project and guardians of the legal model promulgated by the OAS. Accordingly, these lawyers want to assure the project's immediate and continued success.

The final objective of the project, and the final project of the Millennium Challenge in Honduras (which is financing the implementation of the new law), is to permit our business sector to obtain financing at competitive rates. This, in very simple terms, is competition. This is key for the Central American business sector, and most especially for the Honduran business sector. We need to be competitive on par with businessmen throughout the region, with our friends from South America, from MERCOSUR, with our business associates in the U.S., Canada, and Mexico, especially now with CAFTA, which is our primary trade agreement and one of the most important trade agreements presently.

As in the Guatemalan case, the registry we envision and that we hope to accomplish this year will be self-sustainable, electronic, and automated because it cannot entail a burden for the state. If a security interest registry in any country becomes a burden for the state, we know that it will fail. This is because we know that those states, at least those that we are talking about like Guatemala and Honduras, are states with few resources, reduced budgets, and thus with little ability to create new judicial bodies, new institutions that would diminish the state's capacity to finance other social services. Thus, the registry system we are designing will be self-sustaining.

Financial sustainability is absolutely critical for us. But what we have, the great news from Honduras, and I don't know if it is the same in Guatemala, is that the implementation of the law is assured in our case. The reason is because of what Dr. Boris Kozolchyk mentioned at the beginning – the Millennium Challenge Account has a budget of between 2.5 and 3.8 million dollars set aside to finance this initiative. In this way, we are ensuring that what happened with other legal bodies in Honduras is not going to happen here; that is, bills were passed by the national Congress but were never financed properly in order to assure their implementation.

This [lack of financing] has happened to various initiatives. One of these, for example, was a property law passed in 2004, which for a couple of years appeared destined to fail for lack of funding – it enjoyed neither human nor financial resources, those supposed to administer the law also lacked training and the tools necessary to implement the law and make it a success. In the Honduran case, this law of security interests guarantees is certain because the resources are in place and the funding for this initiative has already been set aside. That is exactly the work that I am developing in my country,

channeling investment in order to assure that the registry functions and that the law is in force. We are going to engage technical assistance from international experts that will come to Honduras to train our personnel, to design and implement the registry system. In this technical assistance, we include a plan to improve infrastructure that will interconnect or interrelate the security interest registry with the other existing registries in the country. That is to say, we are also focusing on the institutional fortification of actual entities; the real property registry in Honduras needs a lot of institutional fortification, and we will accomplish this precisely by interconnecting it with the security interest registry. In the same way we will link the security interest registry with the intellectual property registry that already exists in Honduras. We are at the moment creating a vehicle registry – surprisingly, we don't already have one. We do have a vehicle registry for tax purposes, but not for the purposes of guaranties; so, we are making this now and we will interconnect this with the security interest registry.

The training component is key. If the human resources are not prepared to face the challenges of an initiative like this one, the initiative can fail. The Millennium Challenge Account will invest in the training of judges, lawyers, arbiters, bankers, small and medium-sized business owners, registrars, and the rest of the key actors in this process. I thank you for your attention, and I want to focus on a couple of final ideas. Like Mr. Nicholas Klissas said and I concur, for Honduras, a law of real security interests, an initiative involving secure transactions, will in effect achieve a democratization of credit, of access to credit, which has not heretofore been the case in Honduras. Sadly, as Mr. Nicholas Klissas mentioned, access to credit in Honduras has been a great privilege belonging to the social strata with greater economic capacity. These new participants, these entrepreneurs, small and medium-sized, who for so many years have needed access to credit, will finally have it. I agree with what Mr. Nicholas Klissas says about the result being the democratization of the access to credit. I also concur with Mr. Boris Kozolchyk and other colleagues who are convinced that the law, that the rule of law, is a vehicle for social development, and that is what we are doing in Honduras and also what we are doing in Guatemala. In this way, I am affirming what my good friend, Judge Messitte, said that the glass is in fact half-full and not half-empty. Thank you very much.

KOZOLCHYK: Thank you.

MR. ADOLFO ROUILLÓN: Can everyone hear? Thank you, Dr. Kozolchyk. Let me express my gratitude to the organizers and to LexisNexis for taking the initiative and for allowing me to be on this panel today.

On the legal map, there are no islands. All pieces of legislation are interconnected; they are like cogs in a delicate piece of watch machinery and what is done to the law in terms of credit – the legal structure – touches the judicial pyramid. When a law that is linked to credit is analyzed, one starts with constitutional principles and one then follows with an analysis in terms of contract and tort law, the law of guarantees, civil procedure, tax law, bankruptcy law, et cetera.

But, in the middle of this general interconnectedness, there is a legislative nucleus that involves certain norms, which are particularly important for the development of a healthy system of credit – norms that allow for the access of this system by potential users at reasonable rates and costs. This nucleus is composed principally of laws pertaining to guarantees, of legislation that facilitates their creation, the registering and publication of such guarantees, the execution of guaranteed credit, and also those processes related to bankruptcy. This nexus of legal norms is also complemented by the institutions responsible for the application of the rules. The system of credit or the legal system of credit is healthy not only when it counts on modern, efficient laws, but also when the institutions responsible for carrying out their implementation are also healthy and function in an efficient manner.

Having laws linked to credit, as I have already mentioned, plus having the institutions in charge of their implementation (basically the registries, the tribunals, the justice courts and certain administrative entities), are the focus, and have been the focus, of World Bank attention. The World Bank, under the auspices of the international community, is elaborating on a document called "Principles and Guidelines for Effective Insolvency and Creditor Rights."[4] The document compiles good practices to be considered as industry standards. This study is the basis for evaluative or diagnostic studies of

4. *Available at* http://www.iadb.org/res/publications/pubfiles/pubS-804.pdf.

credit systems throughout the world; it is one more tool useful for improving the law and institutions. Utilizing this document since 2002, we have done these diagnostics, these studies, and provided technical assistance in approximately forty countries in various regions of the world, including Latin America, where we have provided assistance in almost all of the countries of the region. A distinct pattern can be discerned from these studies, which are confidential in nature and can only be made available to the public by the respective countries. In the case of Latin America, the studies from Chile and Argentina, available on the World Bank's website,[5] demonstrate that out of twelve Latin American countries, only two countries exceed what would be half of the maximum score to comply with international standards. The remaining ten countries are below fifty percent of the maximum score. I cannot tell you which countries are in noncompliance because of their confidentiality concerns, but I can tell you the big picture numbers. Consequently, this is a region, like many others in which there is a lot to do. The glass might be half-full, but the other half remains empty.

What is the principal relationship that we can find between legislation pertaining to security interests and legislation pertaining to bankruptcy and what are the principal tensions between them relating to reforming or designing laws in these two areas? In the first place, I will warn you that at first blush, the objectives that outline one law or another, a security interest law or a bankruptcy law, appear different. When a security interest law is laid out, it aims to protect credit, it aims to facilitate the creation of guarantees or collateral, of a good system of publishing that reaches all of the community and certainly benefits the creditor guaranteed to avoid subsequent legal matters. A security interest law also takes into account a rapid and efficient system of execution and establishes a hierarchy for creditors that compete for the same good so that the system makes it clear which creditor will have priority at the hour of distribution. When amending a bankruptcy law, you have to ensure that the law not only governs the execution of credit, but also provides opportunities to viable businesses to resolve

5. World Bank - Argentina: Insolvency and Creditor Right Systems, *available at* http://siteresources.worldbank.org/GILD/ROSCAssessments/20111717/ArgentinaROSC%20%5BEnglish%5D.pdf; World Bank - Chile: Insolvency and Creditor Right Systems, *available at* http://siteresources.worldbank.org/GILD/ROSCAssessments/20293918/ChileROSC.pdf; *see generally* World Bank: Global Insolvency Data Base, *available at* http://go.worldbank.org/MI1O2WD3V0.

problems without liquidation. In developing countries, this is extraordinarily important because of the difficulty that exists in creating businesses, in replacing or transferring them when problems arise. These obstacles in developing countries give rise to a different vision – they create basic tensions in three key points with bankruptcy law. The first is the suspension of executions as a consequence of bankruptcy proceedings. These suspensions, if they apply to executions of credit with real guarantees, and if there are no safeguards in place for creditors, including time limits on the duration of the suspensions, can stifle large loan, which will subsequently have a devastating effect on the guaranty regime in general. For this reason, when it comes time to develop the rules relating to the suspension of execution within a bankruptcy proceeding with respect to creditors with real guarantees, it becomes necessary to strike a balance and find a mechanism that permits these creditors in certain circumstances to demonstrate that certain goods used as collateral are not necessary to preserve a business, or sell it, or that the value of the guaranty has been degraded in a way that affects the creditor's priority relative to the good; these are elements that bankruptcy laws have to take into account.

The second area in which tension exists between loans with real guarantees or laws pertaining to real guarantees and bankruptcy laws is in the processes of reorganization or restructuring – that is, just how much loans with real guarantees will be affected by restructuring plans and how much voting and decision power creditors with real guarantees will have with regard to these plans and also how much leverage other creditors will have in imposing conditions on creditors with real guarantees. This is a key point and a point that involves multiple conflicts in cases we have encountered; we have seen a variety of different solutions. Compare a case where maximum protection is afforded to loans with real guarantees, that is to say that these creditors will not be affected by, nor participate in, restructuring plans, making it very difficult for these plans to achieve viability, to the extreme opposite where creditors with real guarantees are included in the system of restructuring without giving them voting rights, without separating the classes of creditors, and allowing creditors at the bottom of the hierarchy to impose onerous conditions on those at the top and those that had secured interests. One example of this type of legislation is Law Number 550 of Colombia, which for all intents and purposes, is

no longer in force in Columbia, but nonetheless established a system of this type.

The third key point in the relation between the two areas of legislation, secured interests and bankruptcy, pertains to the theme of preeminence, priorities, preferences, or privileges for execution of security upon the product of the sale of goods, above all in the cases of bankruptcies and liquidation. In this aspect, Latin America exhibits two camps or two groups of countries that are practically split down the middle. In one group of countries, loans with real guarantees continue to occupy the top rank in the pyramid or hierarchy of credit. On the other hand, in the other group of countries, loans with real guarantees are subordinated to other kinds of demands, especially labor and tax deficiencies. In the systems in which loans with real guarantees enjoy top ranking, the percentage of recuperation in the case of liquidation, even considering suspensions in execution and lag times, continues to be very high.

By way of contrast, in those countries where loans with real guarantees are subordinated to the other categories that I mentioned, the percentage of recuperation is uncertain ex ante for the creditors. Thus, it becomes very difficult for creditors to gauge how well they are covered with the provided collateral because they do not know with whom they will be competing for the collateralized good, if there is an unrecorded creditor, if there are other unrecorded collateralized loans that did not exist when the credit was granted. As a consequence, the system of guarantees becomes very weak. A classic example of this was Brazil before its latest reform of its bankruptcy law. This reform was prompted by studies overseen by the central bank of Brazil, which revealed that tax and labor liens had priority over loans with secured interests, which, in turn, had the effect of making these secured interests practically worthless. There are solutions available to correct this, which I do not have time to mention now.

Needless to say, this is a very delicate political problem, often times with constitutional implications, but one that must be dealt with when it comes time to reform the laws involving bankruptcy. Reform efforts in bankruptcy law, especially those with implications for loans with security interests, have to take into account the insolvency of the debtor, but at the same time, they face the moment of truth with regard to the strength of secured interests. If the bankruptcy system destroys secured interests, it does little good to have a legal framework, aside from the common law, that protects creditors with these secured

interests. Accordingly, like the last two warnings demonstrate, reform legislation must take into account the delicate balance between protecting credit designed to reach the largest group of consumers at reasonable costs and, on the other hand, the objectives of bankruptcy laws designed to keep businesses viable and salvageable as the case may be.

The second observation is that in order to establish this delicate balance and avoid incongruities between the two legislative systems, it is an imperative that the legislator should have a common vision – one that avoids incongruities and makes both systems compatible. Methodologically, the delicate pieces within the watch should be designed by the same watchmaker or by a watchmaker from the same school who understands that he is not bringing good pieces from different systems together to make a good watch, but rather pieces that already function adequately together. Thank you.

KOZOLCHYK: We have a few minutes for questions and answers, so please, if you have any, yes.

AUDIENCE MEMBER: About the new security laws that you were commenting about . . . my name is Mr. Gutiérrez.

KOZOLCHYK: Could you speak up a little bit, please?

AUDIENCE MEMBER: I don't know, I'll try. About the secured transaction laws, I wanted to ask a related question. The practice in Latin American countries of criminalizing certain aspects of the use and abuse of debtors over pledged goods, in the sense that these actions constitute or at least that we consider this to be a kind of scam or fraud if the good is given as a security to the creditor, the creditor wants to seize these goods, and the goods are not there. The question then is, according to Lic. María del Pilar Bonilla or the lawyer, Mr. Marco Bográn, will these new projects continue with some element of criminality or penalty within the law or will this be eliminated? Thank you.

KOZOLCHYK: Yes, thank you.

BONILLA: In effect, Guatemala has in its penal code a law that deals with special scams, and within this law, a situation of this nature is contemplated. The way the law of secured interests is regulated now does not prejudge enforcement from the penal code. That is to say, the penal code continues in force and is applicable to this kind of scam. Scams are not included within the law of secured interests, at least in the case of Guatemala, but they could be included and classified in a general form so that they fall under an action of fraud. That is with regard to fraud. With regard to bankruptcy, Guatemala has a serious problem with fraudulent and at-fault bankruptcies but we hope that this situation improves with the bankruptcy law that is currently being elaborated in order to complement the law of secured interests that is making its way through Congress right now.

KOZOLCHYK: Thank you.

BOGRÁN: Really, the Guatemalan scenario in this sense is exactly the same as the Honduran scenario – we have the same case. The same fraud is criminalized in the penal code and we have the same problems with fraudulent bankruptcies, but, aside from what Lic. María del Pilar Bonilla already responded, more than that, what I wanted to express is that the judicial community that has worked on our project has seen these mechanisms of criminalization for what they really are – a clear reflection of a securities scheme that does not work. This is because if both sides have to resort to such radical extremes—such that one side is criminally accusing the other—what is clear is that the scheme is not functioning. What you have is a scheme in which the debtor really cannot obtain collateral that would permit him to continue on with his productive, entrepreneurial activities, and, on the other hand, a creditor who cannot count on a security or guarantee that is not self-liquidating such that he will eventually have to resort to a criminal accusation – not with the objective of putting the debtor in jail, but instead with pressuring him until in one way or the other he pays. This is what has happened in Honduras, but we are not addressing this problem

specifically because we do not think, well, personally I do not think, that there is a legal void, but rather this is the result of a poorly-designed security scheme with or without displacement in Honduras.

KOZOLCHYK: Let me add something to what the last two panelists just said. Basically, what Mr. Marco Bográn says is absolutely right. But the problem is that the mechanism of criminalizing credit, as Mr. Marco Bográn said very well, is a response to a non-functioning security system. Further, this kind of security functions contrary to the traditional idea of securities, which consisted of fixed secured interests. Guarantees were fixed by legislation, including legislation dating back to the years 1915, 1920, and 1930 having to do with agricultural and industrial securities. Much of these required general savings deposits, which, in turn, impeded the debtor from commercializing on the basically immobile security by not allowing him to sell, resell, transform, or in any way profit from it until it was paid off. The goal of this new proposed law is the creation of a mechanism of self-liquidation, that is, permitting the debtor to mobilize his collateral, to utilize it so that it continues to produce in a way that is profitable. It is curious, the night before last I was reading a book by the great French historian, Ferdinand Lot, about the transition from the mechanism of guilds to capitalism in the Thirteenth and Fourteenth Centuries, there was a directive by the merchants of Paris in 1275 that told all the seamstresses, whether they worked at home or not, that if they had taken loans from creditors and then stopped working as seamstresses, they would be arrested. It is precisely this attitude, this psychology that is on the verge of disappearing with these new laws because what they try to do is decriminalize it and give the debtor the opportunity to mobilize his goods and assets, and with the money he earns from that mobilization, pay the debt. Any other questions, please? Comments?

AUDIENCE MEMBER: Yes, I wanted to ask about something related to securities and mortgages. I worked for twenty-five years for an international organization that finances supervised loans. With supervised loans, supposedly the focus is on the project, not the recovery of the capital. Thus, the procedures were designed so that the project would proceed unimpeded. But we had a series of experiences, and this is what I wanted to say, that there is a problem with

preferential loans with regard to the protection of workers and the right to dietary pensions in relation to collecting collateral. These two points or these two relationships, how do you think or how do you try to resolve this problem, because it is cause for concern in our countries that give preference to labor obligations and their nourishment.

KOZOLCHYK: Yes.

AUDIENCE MEMBER: I am not saying this is bad but these projects stop and so do the goods. In a way that—.

KOZOLCHYK: I believe that, excuse me, the last statement by Judge Messitte is very wise. Recall that when he was talking to us about balancing these two interests, at the end he said that we have to be aware that, by impeding access to guarantees, the bankruptcy process can totally destroy the availability of credit for small and medium-sized businesses. This is indeed a very wise phrase. I believe that a report from the World Bank refers precisely to this problem and adjusts its recommendation depending on the economy of the market in question; if it is a viable market where credit already exists, where there have already been positive experiences balancing the two interests, the World Bank is able to be more flexible with respect to this formula. Before we pass the microphone along, we need to make clear of the principle that not being able to repossess a good does not take away the creditor's right to pursue the economic value of the good. Accordingly, the right to say "I am not going to repossess the original computer or whatever was used as collateral originally" disappears in the sense that the collateral can be converted into money or another movable good that can be pursued by the creditor. Mr. Adolfo Rouillón, please.

ROUILLÓN: Thank you, Dr. Boris Kozolchyk. With respect to food obligations, I believe this is a topic about credit to people, to individuals, right? This is an incredibly delicate subject that does not have much impact on commercial credit. With respect to labor obligations up to now, two alternatives have been studied. One of these is the middle of the road approach taken by Brazil. Recently, this

legislation has imposed limits, or better yet, labor obligations continue to be super-privileged up to a certain point, that is, as long as they are considered strictly related to nourishment. Anything more, these obligations are treated as any other loans that are below in priority to those loans that are collateralized. It is not an ideal solution. The better solution, but what happens is that each country has to determine whether this is feasible, is what Germany introduced in '95, which was to practically remove the risk of bankruptcy from providing labor obligations. And how did they remove it? By providing guarantee funds. In other words, in cases of bankruptcy, labor obligations are not collateralized with goods and instead are paid from guarantee funds.

KOZOLCHYK: Others, yes? Oh, enough? Okay, well then, thank you very much to the panelists. Please join me in a round of applause for everybody.

TAMAYO-CALABRESE: For those who will be panelists in the next panel, please, we ask you to arrive five minutes early to Alemán 1, which is here to the side, next to the LexisNexis poster. Thank you.

KOZOLCHYK: It is a shame that we have to end.