Vietnam

Increasing Access to Credit Through Collateral (Secured Transactions) Reform

IFC International Finance Corporation World Bank Group

MPDF Mekong Private Sector Development Facility

FIAS

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Increasing Access to Credit Through Collateral (Secured Transactions) Reform

FIAS
Investment Climate Advisory Service
A multi-donor service managed by the International Finance Corporation, MIGA and the World Bank

IFC-MPDF
A Multi-Donor Initiative managed by the International Finance Corporation, the private sector arm of the World Bank Group

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For almost 21 years, FIAS has advised more than 130 member country governments on how to improve their investment climate for both foreign and domestic investors and maximize its impact on poverty reduction. FIAS is a joint service of the International Finance Corporation and the World Bank. We receive funding from these institutions and through contributions from donors and clients. FIAS also receives core funding from:

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About IFC-MPDF

Mekong Private Sector Development Facility (IFC-MPDF) is a multi-donor funded initiative set up by the International Finance Corporation in Vietnam, Cambodia, and Lao PDR, to reduce poverty through sustainable private sector development. The Facility works through six interrelated programs that seek to improve the business environment, develop the financial sector, improve managerial capacity, and increase sustainable business practices in three sectors that are central to economic growth and poverty reduction - tourism, agribusiness, and garments. IFC-MPDF's donors are the Asian Development Bank, Australia, Canada, Finland, IFC, Ireland, Japan, New Zealand, the Netherlands, Norway, Sweden, Switzerland and the United Kingdom.

The Access to Finance Program of the Mekong Private Sector Development Facility (MPDF) works with the financial sector to strengthen its institutions and deepen financial intermediation to build strong and well-diversified financial markets. The Facility also works with government, the finance industry and other stakeholders to improve financial systems infrastructure, such as credit bureaus or collateral registries.

Contents

Acknowledgments

Over the past decade, the Government of Vietnam has taken active steps to develop the country's capital markets, restructure existing financial institutions, and strengthen corporate governance. While these measures are commendable, financial sector development remains a major challenge for Vietnam. Additional efforts are necessary to build a sustainable, long-term legal and institutional infrastructure, as well as a financial sector that includes private credit bureaus, a modern secured transactions framework and a security interest filing system.

IFC's Mekong Private Sector Development Facility (MPDF), the Investment Climate Advisory Service (FIAS), a joint unit of the IFC, MIGA and World Bank were invited by the Ministry of Justice to help assess Vietnam's current lending environment and help reform its collateral (secured transactions) laws and registries. FIAS and MPDF have worked with the Ministry of Justice since March 2006 toward this goal; this publication is the result of the project. This report describes the main features of Vietnam's secured transactions law and security interest registries for movable assets before and after recent reforms, explains how the current system has constrained credit development, compares the Vietnamese system with the international best practice, and proposes a series of recommendations.

The project reflects collaboration of a joint FIAS-MPDF team with extensive support from the Vietnamese Bankers Association, Ministry of Justice, and the State Bank of Vietnam. The primary authors of this report are Sevi Simavi (FIAS), Allen Welsh (FIAS consultant), and Everett Wohlers (FIAS consultant). Hanh Nam Nguyen (MPDF) led the financial sector survey and provided critical input to the report. Hung Quang Nguyen (MPDF consultant) analyzed the Vietnamese legal framework and contributed to the relevant chapters. Thomas Davenport (FIAS), Trang Nguyen (MPDF), Russell Muir (FIAS), and Margarete O. Biallas (MPDF) provided invaluable support and oversight to the project.

The contents of this report are based mainly on the financial sector survey, a series of individual and focus group meetings in Hanoi and Ho Chi Minh City, careful analysis of the Vietnamese laws, and international best-practice reviews.

FIAS and IFC-MPDF are particularly grateful to Vietnam's Bankers Association whose support made the financial sector survey possible. We also greatly appreciate the valuable contributions of the 35 financial institutions that participated in the financial sector survey.

Introduction

As Vietnam has transitioned into a socially-oriented market economy over the past decade, the government has undertaken impressive reforms to improve the country's investment climate. While these reforms have contributed to an environment that better supports private sector growth, lack of access to credit has remained the biggest constraint to more widespread business growth. Most small businesses continue to finance their operations through retained earnings or informal sources of credit because of the country's weak legal and institutional financial infrastructure[1].

Economic analysis suggests that access to credit is crucial for economic growth and particularly benefits the poor. Removing barriers to a wide range of financial services can unleash private enterprise productivity and help reduce the size of the informal sector.

Two institutions most efficiently expand access to credit and improve credit allocation: credit-information bureaus and collateral (secured-transactions) laws. These institutions operate best together - information-sharing allows creditors to distinguish good from bad clients, while legal rights help enforce claims when loans are in default. While a well functioning credit-information system is critical, access to credit history alone is not enough. Even in most advanced countries where reliable credit information is available, only the largest and best connected businesses can obtain unsecured loans. The rest have to offer assets as collateral. Therefore, a sound legal and institutional infrastructure is critical to maximize the economic potential of assets that can be used as collateral.

A recent IFC-MPDF diagnostic evaluation of the financial sector in Vietnam confirms that credit-information sharing and the secured transactions framework are two key constraints for access to credit. The diagnostics indicate that only 20-40% of households and private enterprises have access to credit. Lack of reliable credit information is cited as a particularly critical constraint for smaller firms and individuals whose credit history is not well recorded. Further, while lending is heavily reliant on collateral, banks generally do not accept movable assets as security for a loan. Micro, small and medium enterprises are also affected the most by this restriction. As a result, a large segment of private enterprise remains un-served or underserved as, in Vietnam, the domestic private sector remains dominated by small enterprises[2]. For most SMEs, the banking sector remains as the main, if not the only, access to financing. Equity financing cannot be a viable source of long-term funding for Vietnam's private sector because the minimum company size to be listed is markedly larger than that of the vast majority of private enterprises[3]. Therefore, an adequate secured lending framework, supported by an effective credit information system, is a priority for private and financial sector development in Vietnam.

The Government of Vietnam is currently supporting the establishment of a private credit-information bureau that enables banks to evaluate borrowers' creditworthiness. Additionally, recognizing economic benefits of using movable assets as collateral, the government has been undertaking significant reform efforts since the mid-1990s to improve the lending environment. Most recently, the

1 A detailed discussion on Vietnam's investment climate can be found in the World Bank Investment Climate Assessment Report (forthcoming 2007).
2 Vietnam Development Report, Joint Donor Report to the Vietnam Consultative Group Meeting Hanoi, December 6-7, 2005, p. 13.
3 According to the new securities law, adopted on 1 July 2007, companies need to have at least VND 10 billion (US $625,000) to be listed on the Hanoi trading center and VND 80 billion (US $5 million) to be listed on the Ho Chi Minh City stock exchange. Government statistics show that 94% of SMEs have chartered capital of less than VND 10 billion.

government adopted the new Civil Code of 2005 and a new Decree on Secured Transactions in December 2006 to bring the current legal and institutional framework in line with international best-practice principles.

While the new laws are significantly improving the existing lending environment, experiences from other reformers suggest that the legal provisions need to be backed with broader institutional reforms and assistance in implementation in order to maximize the impact. Implementation measures require (1) reforming the operations National Registration Authority for Secured Transactions (NRAST) and updating the current registry to an electronic platform, (2) building capacity within the financial sector in close coordination with the key stakeholders, and (3) monitoring the implementation of laws and fine-tuning remaining shortcomings as necessary.

This report analyzes Vietnam's secured transactions framework and the decade-long reform efforts within the context of global best practices. The report is organized in four chapters.

- The first chapter focuses on how secured transactions laws and registries increase access to credit.
- The second chapter summarizes the constraints of the lending environment in Vietnam.
- The third and fourth chapters provide an overview of Vietnam's legal and institutional framework for secured transactions and analyze recent reform efforts within the context of global best practices.
- Fifth chapter summarizes key policy recommendations for implementation.

The report is also supported by an annex that details international best practices for secured transactions laws and registries.

Role of Secured Transactions Laws and Registries in Increasing Access to Credit

1

Collateral (secured transactions) laws enable businesses to use their assets as security to generate capital - from the farmer pledging his cows as collateral for a tractor loan, to the seller of goods or services pledging the cash flow from its customer accounts as collateral for business expansion. Loans secured by movable assets as collateral - often also called asset-based loans - are an alternative to traditional bank lending because they serve borrowers with risk characteristics that typically fall outside a bank's comfort level. These loans are typically secured by a company's accounts receivable, inventory, and equipment. They primarily benefit start-ups and small and medium enterprises that do not have real estate or land, but have movable assets as their main capital stock.

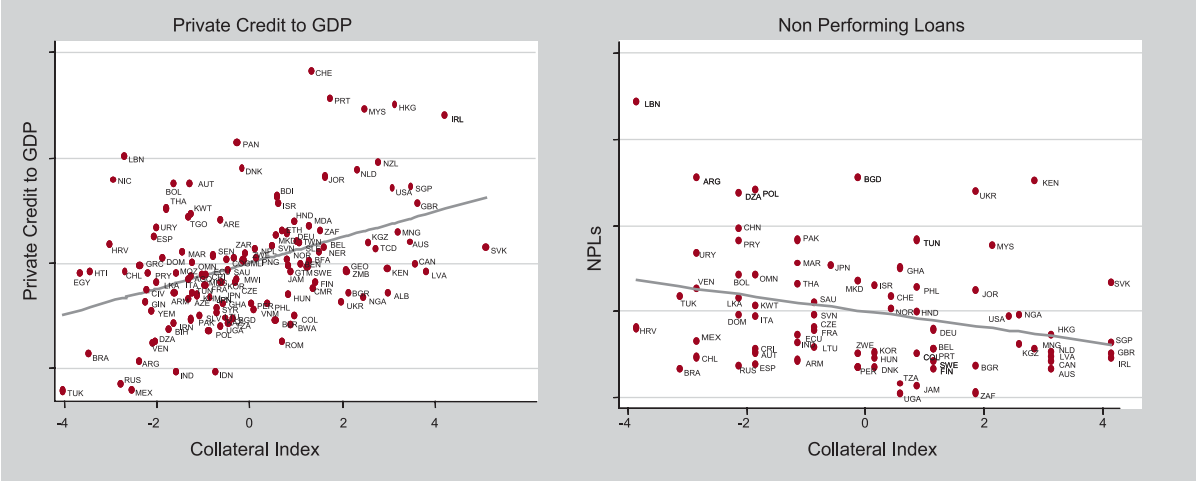
Effective secured transactions laws and registries help borrowers obtain capital and help lenders ensure that they will be repaid. The laws and regulations provide:

- a broad scope of assets that may be used as security;
- clear rules on priority for the secured creditor;
- cheap and simple recording and search of security rights; and
- effective enforcement of security upon default.

Without an effective system, lending is more risky and banks respond by lending less or by increasing the cost of credit to cover their risk, especially to more risky borrowers such as small firms and low-income households.

Economic analysis suggests that reforms to increase the effectiveness of secured transactions law and registries considerably improve a country's lending markets. Countries that score higher on the collateral index have greater access to credit, better ratings of financial system stability, lower rates of non-performing loans, and a lower cost of credit (Figure 1).

Figure 1: Better Secured Transactions Laws = More Credit and Fewer Defaults



Note: Relationships are statistically significant at the 1% level. Private credit analysis controls for country income, growth, and enforcement. Access to loans analysis controls for income per capita.

Source: Doing Business in 2005, World Bank.

Movable assets are a major source of business finance in most developed economies. In the United States, for example, movables account for around 70% of small-business financing. The asset-based lending industry has been growing rapidly since the mid-1970s and the volume of movable asset lending has increased 40-fold over 30 years, reaching a total of US $400 billion. The industry has grown by 12% annually over past 10 years, with most growth coming from larger deals to larger companies[4].

Recognizing the benefits for financial markets, many countries have modernized their secured transactions laws governing movable property. They have broadened the range of movable assets that borrowers can use as security, established collateral registries to help avoid priority conflicts, provided secured creditors with priority to their claims and clarified the rankings of other claimants, and permitted effective, speedy, and inexpensive enforcement of security interests.

The gains from these reforms are already evident. In Slovakia, for example, the 2002 secured transactions law reforms permitted debtors to use all movable assets as collateral - present, future, tangible, and intangible - and abolished the requirement for specific descriptions of assets and debt. Since then, more than 70% of new business credit has been secured by movables and receivables, and credit to the private sector has increased by 10%. In India, the Securitization Act of 2003 now permits state-owned banks, which account for 90% of lending, to enforce security out of court. Further, time to recover collateral has dropped from 10 years to nine months, and banks reported that non-performing loans have fallen[5].

In Albania, after a new law governing the use of collateral was passed and a collateral registry was set up in 2001, the risk premium on lending fell by half, the interest rate spread fell by 43%, and the interest rate on lending fell by five percentage points. The registry now receives an average of 40 pledges a day, and the World Bank Group's Doing Business project ranks Albania fourth (among 154 countries) on the strength of legal rights for borrowers and lenders [6].

4 Commercial Finance Association Annual Asset-Based Lending and Factoring Surveys, 2005.
5 Doing Business Database, 2005, World Bank.
6 Safavian, Fleisig, Steinbuks, "Unlocking Dead Capital: How Reforming Collateral Laws Improves Access to Finance," World Bank, Public Policy for the Private Sector Series, Note Number 307, March 2006.

Box 1: Key Features of a Modern Secured Transactions Framework [7]

Broad Scope of Permissible Collateral. A secured transactions law is most useful when it broadly defines the scope of permissible collateral to include tangible and intangible property of any nature, assets that do not yet exist or are owned by the debtor (future assets), and a changing pool of assets. A single, unitary concept of security interest should be adopted for granting a real right in any movable property from the debtor to the creditor in order to secure an obligation of the debtor. Moreover, the collateral must be described generally and generically to allow the possibility of creating security interests in future assets and fluctuating assets, a prerequisite for modern inventory and receivables financing. Requiring more specific descriptions prevents future and fluctuating assets from being used as collateral, and is cumbersome even for existing assets that are not uniquely identifiable (e.g., raw materials).

Ease of Security Interest Creation. Formal requirements for creating security interests should be kept minimal. Modern secured transactions laws recognize parties' ability to create a security interest as a real right in movable collateral by agreement. Written agreement signed by debtor and identifying the collateral and the secured obligation should be sufficient. No special terminology, forms, or notarization should be required. Parties should have the freedom to address through the security agreement all matters relating to their relationship, including defining warranties and covenants, events of default, and remedies. Importantly, anyone may give security in movables and any person may take security in movables. Security over future assets or a changing pool of assets may be created by agreement without the need for any further acts.

Clear and Comprehensive Priority Rules. Under most modern secured transactions laws, a valid and enforceable security interest does not achieve its priority status against third parties unless it has been "perfected" by either filing a notice in the secured transactions registry or by taking possession or control of the collateral. When several claims secured by the same collateral have all been perfected, priority rules establish the order in which such claims are to be satisfied from collateral proceeds when the debtor defaults. Priority rules must be clear and precise so that a creditor and other persons dealing with the debtor can determine with a high degree of certainty the legal risks associated with granting secured credit.

Priority rules generally consist of a basic rule of "first in time, first in priority" (meaning the first to register or otherwise perfect has priority) and a series of specific rules designed to serve overriding commercial or social purposes. Such rules create exceptions to the basic priority rule by giving preferential treatment to holders of certain interests in the collateral, including purchase-credit providers (in order to promote the extension of trade credit) and buyers of goods in the ordinary course of business (in order to facilitate commercial activities). Additionally, creditors holding non-consensual liens in the collateral by virtue of

7 For further information on international best practice governing secured transactions laws, see the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Secured Transactions.

a statute or judicial process (e.g., the tax authority, a judgment lien holder, holder of a statutory lien, or insolvency administrators) should be subject to the same "first in time, first in priority" rule.

Centralized Publicity System. A key feature of a modern secured transactions law is an efficient centralized registration system. Such movable collateral registration serves two functions: (1) it notifies third parties of the existence of the security interest and (2) it establishes the priority status of a security interest based on the date of registration. Unlike title (ownership) registries such as a real estate registry, a secured transactions registration system does not create or transfer property rights. It merely performs an administrative function. Registry officials should not be responsible for (nor should they have the authority to determine) the authenticity, accuracy or validity of the information provided in the registration document.

Efficient publicity machinery should feature a centralized registration system for all movable collateral, require minimum registration information (identification of the debtor and the creditor and a general or specific description of the collateral should suffice) with no underlying documents, prohibit substantive review by registry officials, offer broad access to the information and, to the extent possible, utilize an electronic system that enables speedy registration and information retrieval.

Effective Enforcement. Speedy, effective, and inexpensive enforcement mechanisms are essential to realizing security interests. Enforcement is most effective when parties can agree on rights and remedies upon default, including seizure and sale of the collateral outside the judicial process. Reasonable safeguards against creditor misbehavior should be adopted to ensure that self-help remedies are exercised peacefully and that commercially fair value is obtained through private sale of the collateral. When the seizure and disposition of the collateral does call for judicial intervention, expedited summary legal proceedings should limit judicial findings to the existence of agreement granting the security interest and of an event of default.

Secured Lending Practice in Vietnam

2

2.1 Background Behind Current Lending Practices

The Vietnamese government has followed international trends by taking progressive reform measures in the area of secured transactions. While the reforms have been implemented with good intentions, they have not yielded the desired impact due to poor implementation and lack of a common vision among various government departments.

The Civil Code of Vietnam was the country's first comprehensive regulation dealing with security interests on movable assets, followed by the Decree 165 [8] adopted in 1999. While this Decree conformed to many essential features of best practice and allowed non-possessory pledges of a wide range of movable property, subsequent decrees and circulars soon began to hamper this progress by shaping the current restrictive lending environment against movable assets. Despite piecemeal attempts to overturn these contradictory restrictions, equipment, inventory, and accounts receivable financing is still very rare in Vietnam.

This chapter will analyze existing lending practices in Vietnam based on the WB-IFC and Vietnam Bankers Association's financial sector survey between October and December 2006 [9]. The purpose of this chapter is to document the constraints and shortcomings identified by the financial institutions and elaborate on how the restrictive legal and institutional framework hampered asset-based lending before the new reforms were introduced in 2006. This Chapter will focus on lending practices, while Chapter 3 will analyze the legal and institutional framework for secured transactions that has led to the current practices.

8 The Decree was adopted on November 19, 1999.
9 For further information on the survey, see Appendix B.

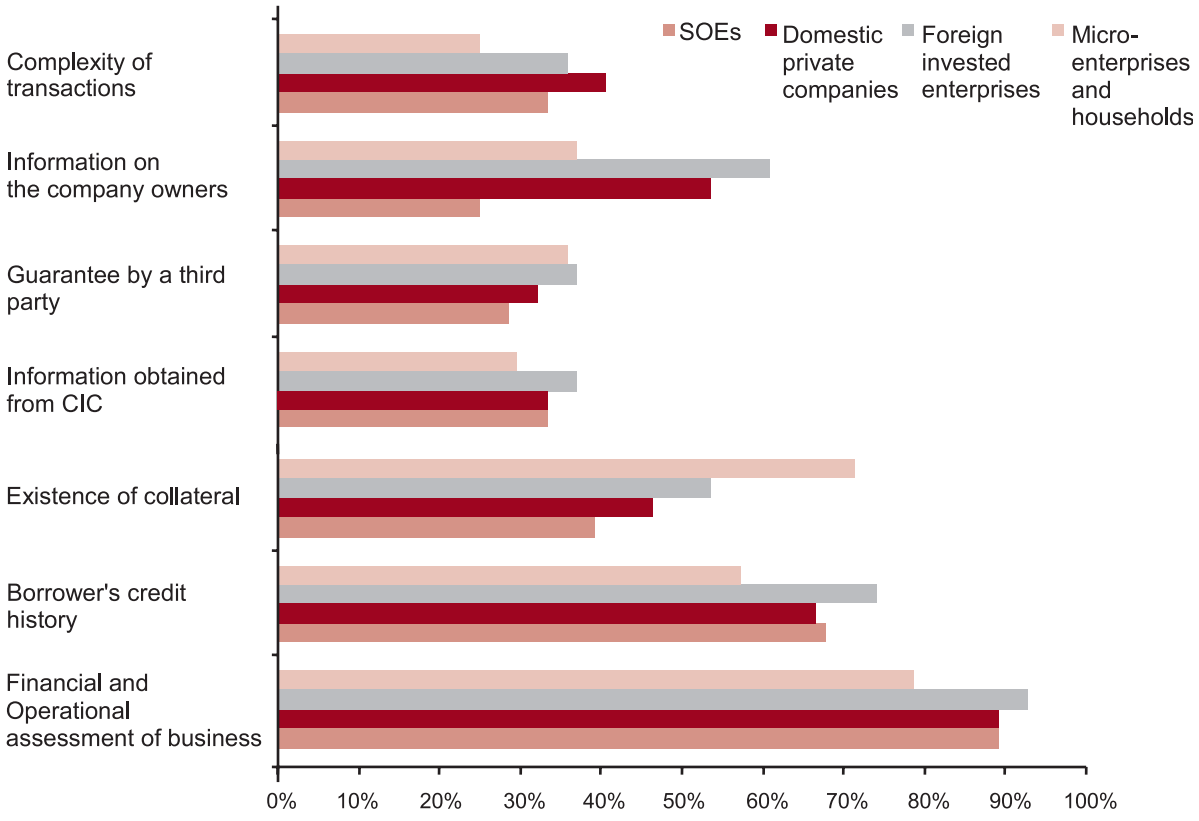
2.2 Current Lending Practices

The financial sector survey found that lending currently differs significantly among local, foreign, state-owned and private joint-stock banks. State-owned commercial banks and private joint-stock banks represent two of the largest groups in terms of market share and offer commercial loans secured by movable assets, especially to SMEs. Foreign banks, on the other hand, mainly serve foreign investors and generally do not offer loans to Vietnamese companies against movable assets.

2.2.1 Lending Decision-Making Factors

Regardless of the enterprise type, the most important factor in a bank's loan decision is the financial and operational assessment of the business. More than 90% of banks regard this as the first and most important factor in determining whether or not loan applications are accepted regardless of the enterprise type. The other two important factors that banks take into account when making loan decisions are borrower's credit history and the existence of collateral. More than 60% of surveyed banks require past credit records for loan application from the four types of enterprises (Figure 2). While the operational assessment and the credit history are important factors in lending decisions, business loans are almost always secured in Vietnam. Especially for micro-enterprises and households, collateral is the most important consideration.

Figure 2: Factors for Making Business Loan Decisions

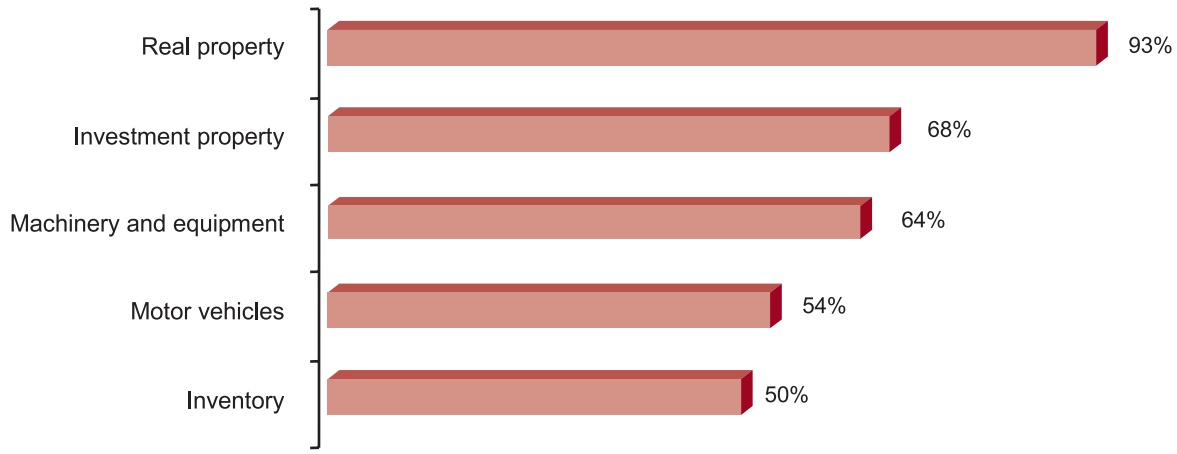


Source: IFC-VBA Financial Sector Survey.

2.2.2 Types of Assets Preferred as Collateral

Lending in Vietnam is biased toward real estate, the most preferred collateral by 93% of banks, followed by machinery and equipment, chosen by more than 60% of banks (Figure 3). Negotiable instruments such as stocks and securities, options and futures, and derivative products are also widely accepted by banks due to their liquidity. Motor vehicles and inventory make up the last two of the top five assets that around 50% of banks would accept.

Figure 3: Top Five Assets Used As Collateral by 24 Banks



Source: IFC-VBA Financial Sector Survey.

Machinery and Equipment

While machinery and equipment is the most preferred movable asset as collateral, limited practical experience and lack of expertise in evaluating these assets are cited among the problems related to this practice. Banks are conservative in making loans against machinery and equipment only, but accept them as supplementary collateral if the value of the primary collateral (generally real estate) is not sufficient. As a result, machinery and equipment financing is often attached to real estate property as supplementary collateral. On the legal side, difficulties in registering interests on these assets as well as enforcement in the event of default are two critical issues.

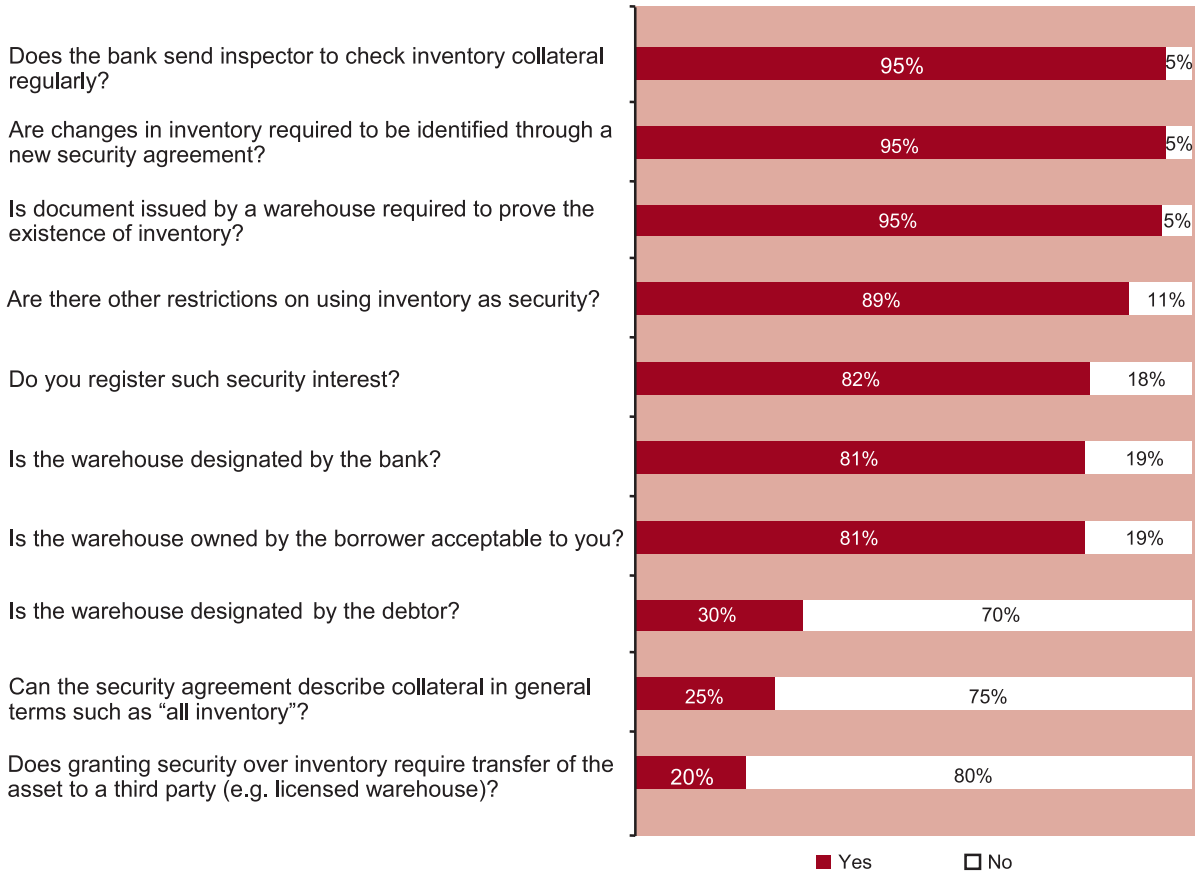
Leasing companies are exceptions as equipment financing is the only product they can offer.

Inventory

In Vietnamese practice, inventory can only be used as collateral by way of possessory pledge (1) under which fixed amounts of inventory are held by lender-controlled field warehouses or (2) when warehouse title documents such as bills of lading can be delivered to lenders. Banks require a formalized procedure for any changes to inventory pledged as collateral, including the inventory value. Such changes must also be registered at the National Registration Authority for Secured Transactions (NRAST). These steps incur additional transaction costs as the borrower must report even the smallest changes and require bank approval. As a result, loans secured by inventory are often granted on a short-term basis.

Such excessive requirements hurt businesses that constantly turn-over inventory. Requiring specific description of assets makes it impossible to finance inventory that cannot be fixed in type, quantity, and location. While the recent legal framework reforms allow general description of assets, banks will need to acquire the skills necessary to offer inventory financing as a standardized product.

Figure 4: How are Banks Currently Exercising Inventory Financing?



Source: IFC-VBA Financial Sector Survey.

Box II: Inventory Financing Models

In the west, inventory is financed by various methods depending on business needs. In nearly all cases, the lender takes a general security interest in all inventory, currently held or acquired in the future.

As inventory is sold, the security interest attaches to any accounts created upon the sale, to cash received in exchange for the inventory, and to future inventory purchased with the cash. This process is made easy by the law's provisions on general collateral descriptions, future-acquired collateral, and proceeds.

There are essentially three inventory financing models depending on the specific business needs.

The most common model is an asset-based loan. In this model, the lender has first-priority security interests on all inventory and accounts receivable. All incoming funds for the business are deposited into the asset-based lender's account. In this scenario, the asset-based lender has complete control over the cash flow. The lender can then manage risk more effectively through weekly monitoring of cash inflows and outflows. The lender is prepared to free up the equity held in inventory and receivables so that more inventory can be purchased to meet demand. Therefore, this model is best suited to most financing circumstances.

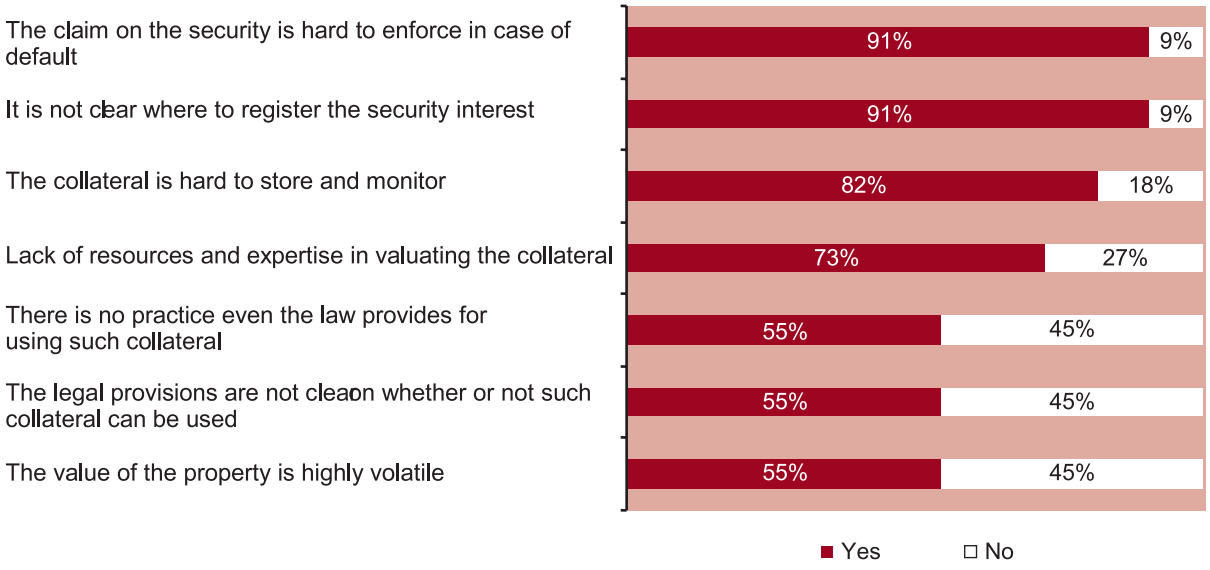
The second model is inventory financing that involves purchase orders. This model is most common with wholesalers and brokers trying to facilitate buy and sell block orders. The inventory lender can potentially finance the purchase of the inventory required to complete the sale provided that (1) it is shipped directly to the borrower's customer and (2) the customer agrees to pay the lender directly. In this scenario, the borrower does not touch the inventory or the payment. Once payment is received, the inventory lender deducts the cost of the inventory and the financing costs and forwards the balance to the borrower.

Finally, in the third model, the lender has complete control over the inventory. Under this model, inventory is purchased with the lender's funds and stored in a third-party warehouse. The lender releases inventory as the goods are paid for. For instance, a borrower may have $10,000 worth of inventory financed under this model. The borrower makes a sale and has to deliver $2,000 worth of the inventory. The borrower pays the lender $2,000 plus the financing costs, and the lender then releases that amount of inventory for delivery. This process would be repeated for each inventory drawdown until all units are paid for. The key to making this model work is that the borrower needs to have enough free cash flow to pay for inventory as he needs it. While this arrangement is relatively safe, it is usually unsuitable for business needs and circumstances because (1) the borrower usually needs ready access to the inventory for sale or lease to customers; (2) warehousing is an expense that businesses frequently prefer to avoid; and (3) day-to-day interaction between borrower and lender may be required to release inventory from storage.

Accounts Receivable

The scope of receivables financing is very limited in Vietnam. This is in sharp contrast to North America where receivables, for example, are often considered more valuable collateral than real estate due to their liquidity and ease of enforcement. One study in the United States found that movable collateral accounted for 67% of all secured lending to small businesses, with receivables and inventory accounting for approximately 66% of that amount. Another study in the United States found that accounts receivable and/or inventory were pledged twice as often as all other types of collateral combined on bank lines of credit to small business. Similarly, when universal security interest was introduced in Slovakia in 2003, more than 70% of all new business credit was secured by movables and receivables. Total credit to the private sector jumped by 10%.

Figure 5: Reasons for not Providing Accounts Receivable Financing/Factoring in Vietnam



Source: IFC-VBA Financial Sector Survey.

The main concern for 91% of the banks in Vietnam is the difficulty of enforcing on receivables in the case of default. The same number of banks also admitted that they do not know where to register their secured interests on receivables. Banks are also concerned that they could not oversee the borrowers' receivables. Further, 73% of banks indicated that they lack the resources and skills to offer bulk receivables financing as a standard product. As a result, those banks that finance accounts receivable provide single-account financing rather than financing on multiple accounts.

2.3 Recommendations

Asset-based lending in Vietnam is currently very limited mainly because until recently the legal framework, coupled with the inadequate registry system, did not create the right infrastructure for

10 Source: Institute for Policy and Economic Development, University of Texas at El Paso (2002), "Analysis of Small Business Lending in Texas," and Berger and Udell (1995) "Relationship Lending and Lines of Credit in Small-Firm Finance," Journal of Business, 68, 352-382.

lenders and borrowers to structure such loans. Details will follow in the forthcoming chapters. The latest Civil Code of 2005 and the new Decree 163 in 2006 contain several positive features to correct these deficiencies and respond to financial community's call for greater conformity with best practices. This legislation offers new possibilities for the secured transactions framework in Vietnam that was previously fragmented, unreliable, and inefficient.

As a result, most credit institutions are not familiar with the asset-based lending business and have not yet realized the economic potential of the recent reforms. It is critical for financial institutions to invest in resources to build capacity and offer new lending products to take advantage of the reformed laws. While the credit institutions themselves are ultimately responsible for their own growth, financial sector constituencies such as State Bank of Vietnam or Vietnam's Bankers Association can lead the process by offering specialized workshops and seminars that provide a forum for information exchange on a periodical basis.

It is also recommended to use the survey results to monitor and evaluate impact of the reform. The survey presents baseline data and provides an adequate picture of the pre-reform environment. Therefore, it will be important to conduct the same survey in two to four years in order to observe the change in lending practices and to address any other shortcomings regarding access to credit.

Secured Transactions Laws in Vietnam

3

In a modern economy, much business wealth is in the form of tangible and intangible movable property such as equipment, inventory, and receivables. Secured credit granted against movable property is extremely important to the expansion of economic activity of small and medium-sized businesses, most of which do not own a significant amount of immovable property. To fully utilize the wide range of movable assets to generate loans, an adequate legal framework recognizing the following key principles must be in place:[11]

- ***Broad scope of permissible collateral.*** A secured transactions law is most useful when it broadly defines the scope of permissible collateral to include tangible and intangible property of any nature, assets that do not yet exist or are owned by the debtor (future assets), and a changing pool of assets.

- ***No restrictions on who can give and take security interests.*** Anyone should be able to give security in movables and any person may take security in movables.

- ***General description of collateral.*** The collateral must be allowed to be described generally and generically to allow the possibility of creating security interests in future assets and fluctuating assets, a prerequisite for modern inventory and receivables financing. Requiring more specific descriptions prevents future and fluctuating assets from being used as collateral, and is cumbersome even for existing assets that are not uniquely identifiable (e.g., raw materials).

- ***Ease of security interest creation.*** Formal requirements for creating security interests should be kept minimal. Written agreement signed by debtor and identifying the collateral and the secured obligation should be sufficient. No special terminology, forms, or notarization should be required.

11 Refer to Appendix C for a more comprehensive discussion on these principles and the rationale behind them.

- Contract autonomy. Parties should have the freedom to address through the security agreement all matters relating to their relationship, including defining warranties and covenants, events of default, and remedies.

- Clear and comprehensive priority rules. When several claims are secured by the same collateral, priority rules establish the order in which such claims are to be satisfied from collateral proceeds when the debtor defaults. Priority rules must be clear and precise so that a creditor and other persons dealing with the debtor can determine with a high degree of certainty the legal risks associated with granting secured credit.

3.1 Legal Framework Governing Secured Transactions in Vietnam Before 2005-2006 Reforms

The Civil Code of Vietnam was the country's first comprehensive regulation dealing with security interests on movable assets. With the subsequent adoption of Decree 165 [12] in 1999, Vietnam enjoyed progressive rules on the scope and creation of security interests in movable property. This decree applied many essential features of best practice and allowed non-possessory pledges of a wide range of movable property including equipment, inventory, receivables, negotiable instruments, documents of title, and intellectual property. It placed no restrictions on who could give or take a pledge nor did it mandate excessive contractual terms. Further, notaries and other third parties did not have to be involved in creating security in collateral or solemnizing the security agreement. While some requirements were unnecessary, the decree contained most basic best-practice requirements and avoided most common mistakes found in traditional approaches to movable property financing.

However, subsequent decrees and circulars soon began to hamper this progress by shaping the current restrictive lending environment against movable assets. Only 40 days after the adoption of Decree 165, the Vietnamese government adopted a new Decree 178 that was applicable to credit institutions operating in Vietnam. As a result, secured lenders became subject to two sets of rules: one set of rules governed credit institutions regulated by the State Bank of Vietnam; another set of rules (mainly Decree 165) applied to both credit institutions and other creditors such as inventory suppliers and other trade creditors. The existence of two sets of rules put lenders in a state of uncertainty and banks could not make prudent decisions based on this conflicting tapestry of legal rules.

Decree 178 included several restrictions and contradictions to Decree 165. For instance, Decree 178 stipulated that an asset could serve as security to only one credit institution [13], and the decree favored possessory pledges over the non-possessory pledges [14]. The decree also added restrictions to a secured transaction. The most significant change was the requirement for collateral valuation [15], which created additional transactional costs and thus decreased access to credit. Further, a

12 The Decree was adopted on November 19, 1999.
13 Decree 178, Art. 11. This restriction was relaxed in 2002. See Decree 85, Article 1, Paragraph 13.
14 Decree 178, Art. 12(1).
15 Decree 178, Art. 8.

purchase-money loan[16] could be made only if the government directed the loan or if the asset was purchased for use in a "medium- or long-term investment project" and the debtor met specific criteria[17].

In 2002, Vietnamese government issued yet a new set of rules - the Circular 6 - which imposed even further restrictions on the use of movable property as collateral. Contrary to Decree 165, the new rules required future-acquired inventory to be specifically described[18]. Further, in addition to having to add the new specifications to the security agreement, the amended agreement also needed to be registered at NRAST to reflect the new and more specific descriptions.

Similar to the restrictions on the scope and creation of the security interests, priority rules among creditors also remained very weak in Vietnam. While a basic, first-to-file priority rule was adopted, it was limited to only creditors with a non-possessory pledge[19]. There were no provisions concerning the rights of pledgees who took possession of the collateral rather than registering. Further, the legislation did not specify creditor's rights to the collateral upon its sale, or whether the sale was under ordinary business circumstances or otherwise. There were also no provisions to resolve conflicts when collateral was severed from immovable property, when collateral became fixed to immovable property, or when collateral was commingled or united with other movable property.

The state's claim over collateral remained superior to a secured creditor's claim even if the state's claim arose after the security interest. Further, Vietnamese law contemplated a very narrow range of commercial conflicts among competing creditors. As a result, movable property remained as unpreferred collateral in any event, and there was little enforcement action. There are currently no court rulings nor a common legal interpretation, and few, if any, anecdotes regarding how conflicting interests on collateral should be resolved under various decrees and circulars. The result is a lack of a common understanding regarding priority rules and factors affecting priority in the lending community.

Despite piecemeal attempts to overturn these new, contradictory restrictions[20], new equipment financing has been crippled by the Decree 178 restrictions on purchase-money loans. Inventory financing has become nearly impossible with the circulars' requirements for detailed collateral descriptions and registrations. The decrees and circulars have not improved the framework for financing of accounts receivable, either. As the financial sector survey indicates, borrowers and lenders have not been able to utilize the full value of their assets and they have been limited to short term funding corresponding to their specific transactions.

16 In this discussion, a purchase-money loan refers to a loan that enables a debtor to acquire specific goods, whether the credit is extended by a seller, supplier, or third-party creditor. A lessor under a finance lease extends purchase-money credit.
17 Decree 178, Art. 14.
18 Circular 6, Art. II.2.3.
19 Decree 165, Art. 14(3).
20 Finally, in an apparent attempt to liberalize restrictions on practice imposed by Decrees 178 and 85, the State Bank of Vietnam issued Circular 7 (19 May 2003). With this Circular, mortgages of movable property were authorized, including tangible and intangible assets, present and future. Note that Decrees 165, 178, and 85 generally relate to a pledge of movable property, not a mortgage. A number of formal requirements are imposed on a mortgage of movable property. The circular retains the requirement of specific descriptions of future-acquired inventory in amended agreements and registration statements.

3.2 Reforms After 2005: A New Beginning

The Civil Code of 2005 is yet another legal reform in the area of secured transactions. This Code contains provisions on movable property as security that are broadly in line with those in the original Decree 165, but under the new notion of "mortgage" for non-possessory security interests rather than "pledge". The Civil Code recognizes the fundamental principles of secured transactions law and does not leave them to lower level legal authorities. This is a positive step forward for the predictability of the secured lending regime in Vietnam.

Further, a new Decree 163 was adopted in December 2006 to elaborate on the framework provisions of the new Civil Code. Most importantly, Decree 163 repealed the complicated and backward-moving Decrees 178 and 85. Presumably, circulars that further complicated the administration of Decrees 178 and 85 also fell by the wayside.

The Civil Code of 2005 and Decree 163 contain a number of positive features that respond to the financial community's call for greater conformity with best practices. This legislation offers new possibilities for secured lending, though lenders may be slow to warm up to the provisions as they assess their new opportunities. Positive response to the improved provisions on scope and formalities of secured lending will also depend on the reform of registration and enforcement provisions discussed in the following chapters.

A summary of the improvements is as follows:

- *All kinds of movable property can be used as collateral.* A mortgage of movables may be created in tangible and intangible property of any nature, including property that arises in the future.
- *Formalities for creating security interests are simplified.*
- *Collateral may be described generally* (Decree 163 Art. 11).
- *Greater freedom of contract.* The parties have the freedom to address through the security agreement all matters relating to their relationship, including defining warranties and covenants, events of default, and remedies. Further:
  - The legal requirement of the maximum debt ratio has been eliminated.
  - The value of collateral need not exceed the value of the secured obligation (Decree 163, Art. 5).
- *Priorities between different creditors are clarified.* A general priority rule favors the first to register with respect to the collateral.[21]
- *A mortgage of accounts may be made flexibly,* and without notice to obligors on the accounts (Decree 163, Art. 22).
  - Buyers of collateral are subject to a mortgage on movable property when the sale occurs after registration. An exception is made for buyers in the ordinary course of business, such as buyers of goods from the inventory of a store, even if the goods are subject to a mortgage.[22]

21 See the 2005 Civil Code, Sections 318 to 325, and 342 to 357. Note that the priority rule applies only to competing claims under transactions listed in Article 318.
22 Decree 163, Art. 20.

- A secured party who takes a mortgage of accounts need not worry that the accounts are already subject to an assignment or sale[23]. The decree states that priority under both of these transactions is determined by order of registration.[24]
- Some protection is provided to secure creditors if mortgaged goods become accessions to, or become commingled with, other goods.[25]

- A super-priority for some, but not all, purchase-money lenders is allowed. Super-priority is granted in favor of creditors that use specific forms such as installment contracts or finance leases for the purchase on credit of machinery.[26] Super-priority is not useful, however, to a bank that lends money to enable a borrower to purchase goods (unless the bank is the financier in a lease transaction).

3.3 Recommendations for Implementation

Recent reforms provide an improved legal framework for secured transactions. However, banks have not yet realized the potential benefits such as ability to take a global security interest on bulk inventory or accounts receivable as collateral. To yield the desired impact of the reform, the Government of Vietnam should address the remaining areas that have not been addressed under the current laws. The government should also adopt an effective implementation and monitoring strategy together with other stakeholders.

In any event, government should not adopt any additional decrees. They are not necessary and creditors report that they prefer to have secured transactions rules combined into a single measure. If circulars are required pursuant to Decree 163, they must refrain from adding requirements or restrictions on the parties' freedom to structure agreements as they choose. The provisions of a circular must under no circumstances contradict or detract from the rights and opportunities granted in the Civil Code or Decree 163.

While the Civil Code and Decree 163 are comprehensive, the following areas within the scope of Decree 163 should be incorporated or clarified in order to benefit the lending environment.

- Ensure a secured creditor's right to proceeds upon the sale or other disposition of collateral. This right is important to a well-functioning secured transactions legal system.

  A concept found in almost all modern secured transaction systems involves recognition that a security interest automatically extends to property, referred to as "proceeds," acquired by the debtor as a result of disposition or other dealing with that collateral or its loss or damage. The right to assert a security interest in proceeds is particularly important in inventory financing where there is an express or implied power given to the debtor to sell the original collateral. The secured party knows that the original collateral is to be sold and, consequently, looks to the proceeds (in the case of inventory or cash) in place of the original collateral. Proceeds are also important for goods-in-process (e.g., goods being manufactured) and for agricultural products (e.g., seeds that are transformed to wheat, then to flour, then into cash).

22 Decree 163, Art. 20.
23 Civil Code, Section 309.
24 Decree 163, Art. 22(4).
25 Decree 163, Art. 27(2).
26 Decree 163, Art. 13(2).

Modern secured transactions law does not force a secured party to take separate security interests in each type of proceeds acquired by the debtor, or to take security interests in all future movable property acquired by the debtor. Rather, the law recognizes that a security interest in collateral automatically carries over to property received by the debtor as a result of dealing with the collateral or as a result of damage to or destruction of the collateral. While a security interest in proceeds is treated as an extension of the security interest in the original collateral, the kinds of property that are claimed as proceeds collateral should be recorded in a registration relating to the charge of the original collateral.
While parties to an agreement may be able to contractually provide for remedies with respect to proceeds in Vietnam, the decree should explicitly provide for this right.

- Adopt a comprehensive and commercially rational order for prioritizing secured claims against non-consensual claims.

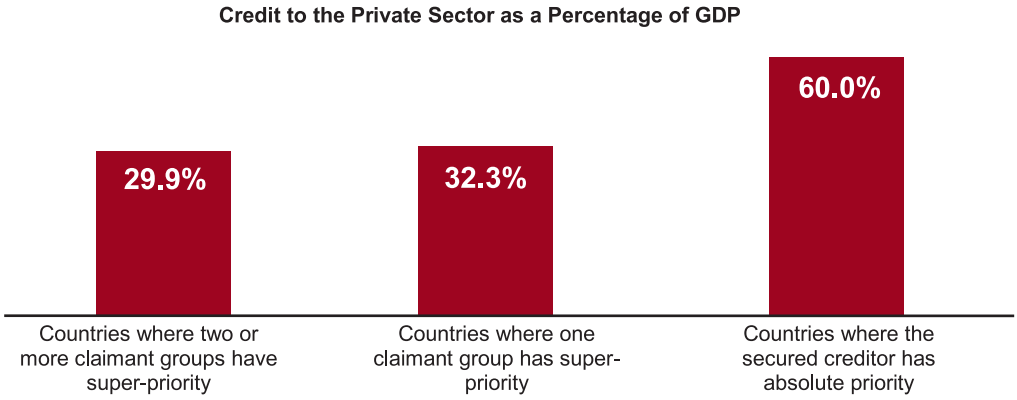
  In many jurisdictions, public policy gives preferential treatment (super-priority) to certain categories of claimants (e.g., tax authorities, workers, judgment creditors, and insolvency administrators) whose claims arise without the debtor's consent. Such claims, generally referred to as "liens," are granted the status of security interests by virtue of a statute or judicial process and may sometimes be given super-priority rights over consensual secured claims.

  A proliferation of non-consensual liens with super-priority creates uncertainty and risks for existing and potential secured creditors when the liens cannot be easily discovered. Unless non-consensual liens were publicly disclosed, it would be difficult or impossible for secured creditors assess the risks associated with granting secured credit.

  Modern secured transactions systems best facilitate credit markets and business activity where (1) liens are fully disclosed through publication, and (2) liens are not granted super-priority status over prior secured creditors. To this end, best-practice disclosure calls for all non-consensual liens to be registered in the secured transactions registry. For example, in the United States, tax liens must be registered in the general secured transactions registry in order to establish their priority status in the collateral. Only those tax liens which are registered prior in time have priority over consensual security interests. While few jurisdictions require judgment creditors or insolvency administrators to register notices of their claims with the security registry, such claims must be disclosed through other appropriate publicity mechanisms in order to be ranked ahead of a later perfected security interest.

  Globally, 52 countries provide the secured creditor with absolute priority. Another 37 provide super-priority to one other type of claimant (mainly taxes or workers) and 45 provide super-priority to more than one other type of claimant. The effect on credit markets is significant: for each additional type of claimant that ranks ahead of secured creditors, the amount of credit to private businesses falls on average by 30 percentage points (Figure 6).

Figure 6: Access to Credit is Greater when Secured Creditors Have Priority



Source: World Bank Doing Business project database.

Further review the super-priority provision in order to promote commerce. Super-priority for equipment finance should include any form of transaction. It should also include secured parties whose credit enables the purchase or lease of equipment. Inventory, livestock, and fixture[27] financing are also worthy of super-priority rules.

Modern secured transactions laws use super-priority rules to promote sales credit, particularly in equipment, inventory, livestock, and consumer goods. A creditor with super-priority may enjoy priority over previous secured creditors, even though the latter may have registered first. Super-priority rules are created in favor of creditors that lend money for the purchase of specific property (provided that the debtor actually uses the credit to complete the purchase). Such creditors are referred to as purchase-money creditors. Without super-priority status, a purchase-money creditor would be unwilling to supply secured credit when the property buyer had previously granted a general security interest in all of its existing and future-acquired property or in the kind of property that the buyer wished to obtain and a registration relating to that security interest had been effected.

- Periodically review progress under the new Civil Code and Decree 163. The Government of Vietnam should systematically monitor the implementation of the new laws in practice. The review should provide meaningful opportunities for creditors and entrepreneurs to voice problems with the legal framework, if any.

27 "Fixture" means movable property that becomes fixed to immovable property in such a way that rights in the movable property arise under land laws, land-use rights, or mortgage of land or land-use rights.

Institutional Framework Governing Secured Transactions in Vietnam

4

4.1 Secured Transactions Registries

4.1.1. Rationale for Secured Transactions Registries

Within modern commercial transactions, security interests are created on a non-possessory basis, meaning that the borrower keeps and uses the collateral that has been offered as a security to a lender. This feature of modern finance is critical: a merchant must have possession of inventory to market it; a contractor must have use of equipment to perform contracts; and an agricultural producer must have machinery to plant and harvest crops.

In many cases, third persons may be deceived by a debtor's possession or control of movable property. How can a prospective lender or a buyer determine if someone else has an interest on a piece of property? Publicity of information relating to security interests provides a solution to such problems and serves as the core of every modern secured transactions system. Its essential value is that it helps creditors to assess and avoid risk. Published information discloses the existence or potential existence of interests in identified movable property to persons who intend to purchase or to take a security interest in it.

The underlying approach is that full recognition of prior security interests in movable property is conditional upon public disclosure of the interests in a prescribed manner - usually through filing a notice in the registry. Additionally, publicity provides the basis for determining priority among competing security interests in the collateral..

All modern secured transactions registries adopt a registration method commonly known as "notice filing" rather than "document registration". Unlike a document registration system, a notice filing system does not require the actual security agreement to be registered or even tendered to the registry. Instead, the secured party submits limited information in a standardized format. This information is nothing more than the basic factual particulars needed to alert third parties to the potential existence of a security interest in identified items or classes of movable property of the named debtor. The underlying agreements are not placed in the registry records.

The notice filing concept was developed with the first modern secured transactions laws established in the 1950s in the United States. Other countries such as New Zealand, Albania, Bosnia, Cambodia, and Romania that have adopted modern secured transactions laws have also adopted some version of notice filing.

Under modern secured transactions laws that use notice filing, the only purpose of notice filing is to publicize the interest and thereby establish priority. Since the notice does not create rights, it is possible to dispense with the formalities and legal examination that are associated with traditional registration. An important consequence is that it is not the responsibility of the registrar to determine whether or not a valid security agreement exists between the persons named in the registration as secured party and securing party or that the registration has been authorized by the securing party.[28]

A notice-filing system has the following features and benefits:

- It can handle large numbers of registrations and provide public access to registered information efficiently and cost-effectively.
- There are no requirements for notarizing documents or valuing collateral. Subsequently, registration fees paid by system users need not be a significant factor when deciding whether or not to register or conduct a search.
- It provides flexibility for system users. That is, it responds to the needs of modern commercial financing, which often involve multiple agreements or amendments to agreements and indeterminate credit obligations such as lines of credit and credit facilities for ongoing advances. With the passage of time, details of a credit arrangement such as the loan amount become outdated as a result of refinancing. Security agreement terms can be amended or new agreements entered into between parties as circumstances change without having to amend the registration or affect new registrations as long as the changes or new agreements do not affect the basic information in the registration.
- Notice filing reduces significantly the need to disclose to competitors sensitive business information. The skeletal information in a filed notice is available to anyone willing to pay the price of a search. However, the details of the relationship between the parties to the security agreement (such as the amount of indebtedness secured, repayment terms and, in some contexts, the details of the collateral involved) are not publicized. Therefore, such details are not disclosed in a search.

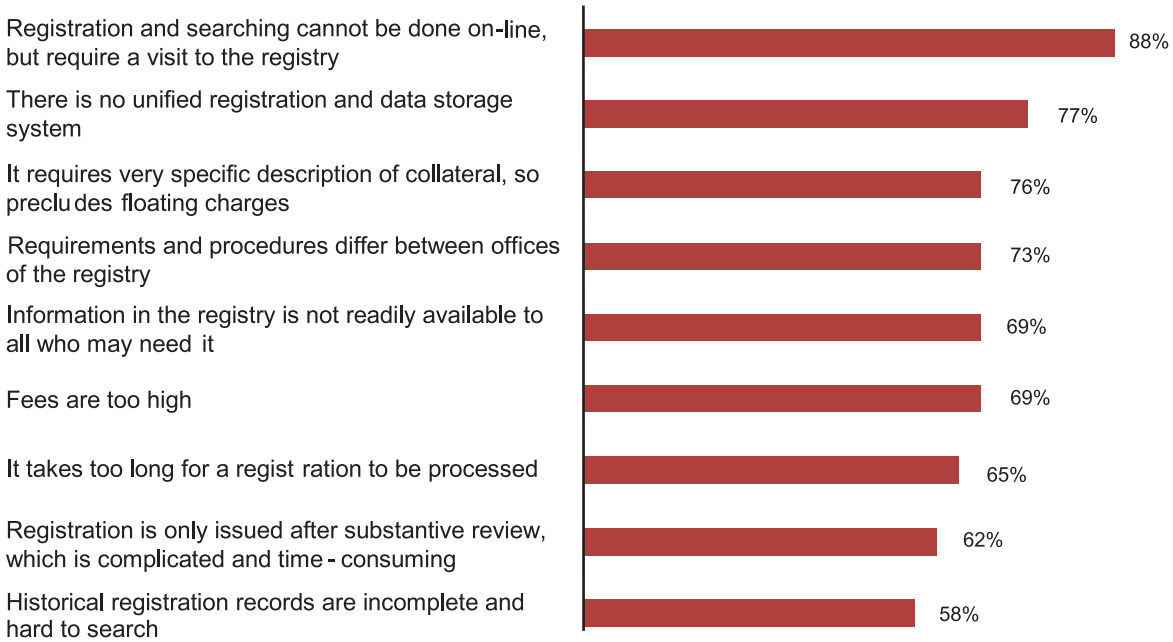
4.1.2 Key Constraints for Security Interest Registration in Vietnam

In March 2002, the National Registration Authority for Secured Transactions (NRAST) was established to register security interests on all movable assets and leasing transactions, with the exception of ships and aircraft.[29] While NRAST is a single system for most security interests in movable assets, it is has significant flaws and is not user-friendly, primarily because it remains paper based - which is the number one constraint cited in the survey of financial institutions.

28 However, many systems contain measures to address situations where a registration does not represent an existing or potential relationship between the parties identified in it and the person named as debtor requires such registration to be discharged.

29 Under the Vietnamese law, the prevailing legal authority for registration is found principally in Decree 8 (adopted in 2000) and Circular 6, which were adopted on 28 September 2006. Circular 6 sets out the required content for registration applications. With the recent reforms, both the Civil Code of 2005 and Decree 163 authorize registration in general terms and leave the specifics to special laws or decrees. There is as yet no post-Civil Code ordinance or decree on registration, though the government is working on a proposed ordinance. On 17 May 2007, a circular (Circular 3) was adopted to amend Circular 6 to reflect the new Decree 163. On the same day, another circular (Circular 4) was passed to provide for registration of conditional sales, assignment of debts and leases.

Figure 7: Problems with NRAST



Source: IFC-VBA Financial Sector Survey.

Following is an explanation and analysis of banks' key concerns regarding NRAST.

Data is paper-based and not unified into one electronic system. 88% of the surveyed banks agree that online registration can facilitate both registration and searches of security interest notice. All of the banks believe that an online system will improve the efficiency of all parties involved. Although some banks express some degree of satisfaction with faxing applications, they would prefer more advanced registration facilities that fully utilize technology to facilitate the process. Furthermore, 70% of the banks are concerned that the unified registration data is not readily accessible, hindering their access to information on secured interests of fellow banks.

The registry's authority to include all types of interests that should be publicized remains unclear. The new legal framework for secured transactions generally takes an expansive view of the types of obligations that can be secured by interests in movable property and makes registration of these interests a prerequisite for validity against third parties.[30] While the most recent circular for registration of security interests and other non-possessory interests in movable property is accordingly expansive,[31] there is as yet no higher level law or regulation recognizing this principle[32] and there remains some question about the scope of interests that may be registered.

Under the current practice, registrars still exercise some discretion in examining applications for registration. The new legal framework has reduced the potential for excessive substantive examination of applications by the registration offices. A registrar may no longer require that the applicant provide additional documentation relating to the transaction. However, registrars are still required to make judgments about the legal form of the transaction and the type of collateral.

30 Article 323, Civil Code, and Article 11, Decree 163.
31 Circular 03/2007, and Circular 04/2007.
32 Decree 08/2000.

Registrars must also determine whether or not an application is identical to a previously registered application, but this should not be a matter of concern to the registry.[33] Finally, in Vietnam the registry clerks are lawyers, and lawyers are generally inclined to examine documents judgmentally. Instead, registration should be merely administrative.

As a result, within the current legal framework, it remains likely that registrars will apply discretionary judgment in making decisions to accept or reject notices, though to a far lesser extent than under prior legal framework. According to best practices, however, the registry system should not permit any human discretion. It should employ fixed rules for accepting or rejecting notices and determining what notices to report in a search, so that results are consistent and predictable in every case. An electronic registry where applications are accepted and searches are done by the technology system's application of fixed rules will eliminate discretion.

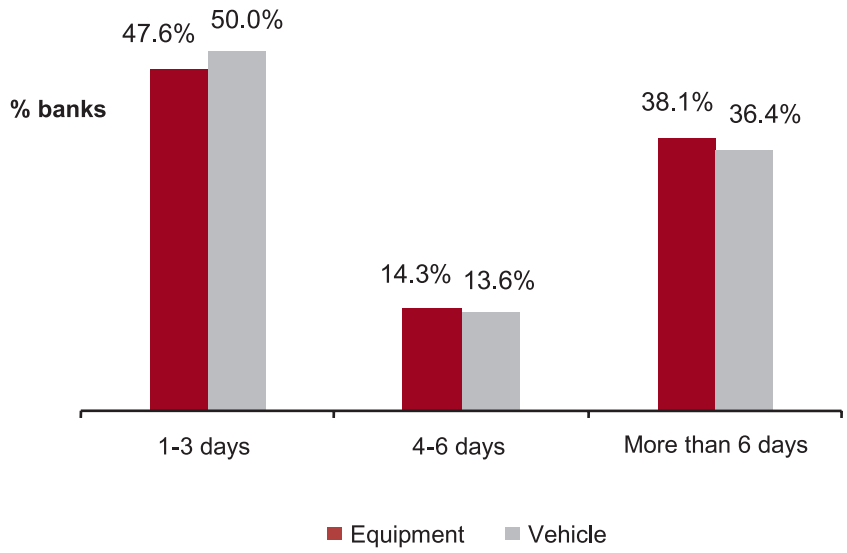
Registrars may be tempted to examine collateral descriptions and require detail because of the provision for "description of collateral" in the old, but still effective, regulations for registration.[34] The implementing circular's provision on registration provides forms and attached schedules with fixed formats for descriptions.[35] Provision of forms calling for detailed descriptions with fixed formats can easily be construed by registrars to support rejection of applications with formatted, general descriptions of collateral.

Registration method limitations discriminate against occasional registrants. Applications for registration can be submitted by personal delivery to a registration office, by post or by fax, though submission by fax is restricted to those who have established a client account with the registry.[36] It appears that the basis for this discrimination between clients and non-clients is that clients may make payments into the client account with the registry, to which they can charge fees for services such as registration by fax, whereas non-clients may not use fax for registration because they must pay fees in cash at the time they submit an application.[37] The registry therefore places non-clients at a disadvantage because they cannot use the fastest means of submitting applications. There appears to be no rational basis for this discrimination because the way clients pay for their accounts, i.e., to the registry's bank account, could easily be adapted to permit advance payment of fees by non-clients who could then register by fax.

Registration requirements are burdensome and time-consuming. The financial sector survey found that banks complain about the complex and time-consuming registration process. Though the statutory time requirement for registration was only three days, 13.6% of the surveyed banks reported that registering a security interest on a piece of equipment typically takes four to six days, and 36.4% of the surveyed banks said that registration takes more than six days. New legal authority provides a stricter standard for registration time, calling for same-day registration if received by 3pm, with an exception permitting up to three days in unusual circumstances. Anecdotal evidence from more recent interviews with several banks suggests that performance has improved since the period on which the survey reported, with compliance with the one-day registration requirement being a more common experience. Registering an interest in a motor vehicle was reported by survey participants to be generally easier than registering in a piece of equipment because the number plate on each vehicle expedites document checking at the registry (Figure 8).

33 Circular 6, Part I, Point 10.1.
34 Article 11, Decree 8.
35 Circular 6, Forms 01 and 02, and Annexes 01, 02 and 03.
36 Circular 6, Part I, Point 11.1.
37 Circular 6, Part I, Point 11.2.

Figure 8: Days to Register a Security Interest



Source: IFC-VBA Financial Sector Survey.

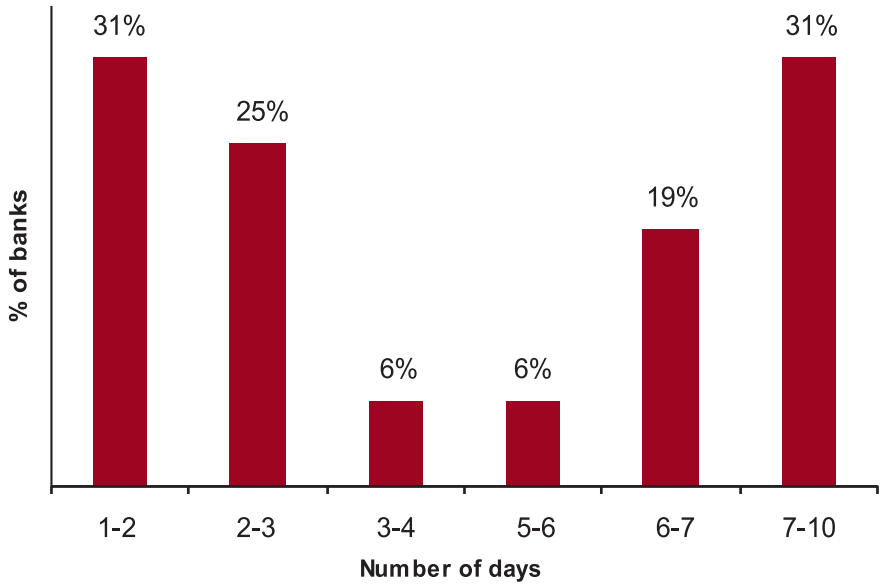
Search results are inaccurate and the response time for searches is lengthy. The time of registration is the date and time at which a valid application is received.[38] Registration applications are currently reviewed and then keyed into the database by registrars. Under the new legal standard, this is to be done within the same or next working day, though in some cases it can take up to three working days.[39] Once the data is input at a registration center, registration information is not available for searches until after the synchronization of NRAST databases, which is made twice a day - at the end of morning and afternoon working sessions. As a consequence, information that the registry provides to searchers during the minimum half-day gap between receipt of an application and the following database synchronization does not include the most recent registrations. Searchers, therefore, do not receive information on all effective registrations and can potentially make decisions based on incomplete information.

Another issue is that the relevant registry regulations provide for a search for information on a securing party to be conducted according to the name of the securing party.[40] Having one search criterion, e.g., a name, enables users to obtain consistent results. However, in practice, the NRAST registration offices conduct searches using the combination of both name and identifying number when responding to requests for information. This practice not only fails to conform to legal authority, but it creates great risk for secured parties who may have made an error in the number but gotten the name correct. In that case, a search, requiring a match on both criteria would not find a notice that is legally sufficient; that is, it would not find a notice on which the name is correctly entered, but on which there is an error in the number. Indeed, the survey showed that the financial community does not fully utilize NRAST to conduct searches, as the banks find the process to be lengthy and the search results unreliable. The survey reported that it takes banks between one and 10 days to receive a reply for a search inquiry. More than 30% of the banks received search results on their inquiries within two days, and another 25% of the

38 Article 21, Decree 8, and Circular 6, Part I, Point 8.1.
39 Circular 6, Part I, Clause 13.
40 Article 24, Decree 8, and Circular 6, Part IX, Clause 1.

banks received results within 3 days. It took 31% of banks between seven and 10 days to receive results from the registry (Figure 9). Under the new standard for processing time for searches, which is the same as for registration[41], NRAST is improving its performance in this respect.

Figure 9: Turn-Around Time for Information Retrieving/Search



Source: IFC-VBA Financial Sector Survey.

The answer to both problems with searching (the gap between registration time and availability of information to searchers, and the processing time for searches) appears to be in using information and communications technology effectively. Some 88 % of the surveyed banks agree that online registration can facilitate both registration of and searches for notices of security interest. All of the banks surveyed believe that an online system will improve the efficiency of all parties involved. Although some banks express some degree of satisfaction with faxing applications, they would rather use more advanced registration techniques that fully utilize technology to facilitate the process.

Other deterrents to registration. Nearly 70% of responding banks in the survey found that registration fees are too high. While it is difficult to understand how a financial institution would find a VND 60,000 (approximately US $4) fee to be a deterrent, the effective use of technology to transfer much of the labor cost of the registry to the end user could permit a significant reduction of even that modest amount.

Other complaints included the requirement for specific description of collateral and substantive reviews of documents. These complaints would appear to have been addressed, at least in part, in the most recent legal reforms.

Another concern is that either a secured party or securing party can apply for his/her registration of security interests to be deleted.[42] Permitting a securing party to remove or delete a registration, with or without the consent of the secured party, can put the secured party at great risk. Even if it is the

41 Circular 6, Part IX, Clause 3.
42 Article 23, Decree 8, and Circular 6, Part VI.

secured party who applies for removal or deletion, it is better to add the application for removal to the registration file and leave the registration file in the active archive, rather than deleting the registration from the active archive, because the registration may still be relevant to an inquiry by a third party.

4.1.3 Recommendations for Publishing Security Interests with a Unified, Centralized Registry

The Government of Vietnam is currently working on a proposed Law to improve the country's registration system, in part by transitioning registry operations from a paper-based system to an electronic platform. The scope of this new law should be carefully drafted to coordinate with Decree 163. In order to bring the registry operations in line with international best practice, it is recommended that the following points be incorporated into the law and the design of the new registry:

- **Unity:** The registry should provide for registration of all types of relevant interests and include security interests in movables (including fixtures), finance leases, long-term operating leases, the sale of secured sales contracts and liens in movables. NRAST should be careful not to exclude certain types of movable property from registration.

  In legal form, finance leases, long-term operating leases, the sale of secured sales contracts, and liens are not true security interests. However, it is important that they be included in the registry and that they be bound by the same priority rules as true security interests. The reason is that, without registration, the leasehold interests or sale of secured sales contracts could remain hidden from third parties who may rely on the securing party's apparent ability to transfer them. The new legal framework goes a long way in this direction, but still is not framed as broadly as desirable. The registry can easily accommodate registration of notices of all such interests without significant difference from what is required for true security interests.

  Limited purposes: NRAST should ensure that registration requirements serve only the legitimate purposes of registration. Those purposes are to give notice that a security interest may exist in the identified collateral and to establish the secured party's priority in the collateral. Extraneous information should not be required. For example, registration information on inter-secured party contracts, e.g., subordination agreements, is not germane to third parties, but is provided for in the registry forms.[43]

  If motor vehicles are to be indexed and searched by number, the registry should apply to them the same general rule that it applies to indexing and searching by securing party. That is, only one number should be used, and it should be the number that identifies the vehicle, not removable components. The appropriate number is most commonly the vehicle identification number (VIN) or frame number, as specified by the relevant legal authority. Other numbers, such as the motor number, are not necessary since they identify a component that may be removed or replaced and are therefore unreliable for identifying the vehicle.

43 Circular 6, Form 02 BD, Item 3.1 ("Change of priority order with respect to payment").

The registry serves an informative function by enabling archive searches. A regular search request (not a certified search) should require only the minimum information on which the search is conducted, i.e., the search criterion (securing party name or vehicle VIN or frame number, as appropriate). Information on the requesting party beyond that which is necessary to return the result set should not be required.

Rule-based decision-making: Acceptance and rejection standards for registration and rules for conduct of searches must be concrete, specific, and limited. Reasons for rejection must be objective so that no discretionary judgments are involved in the decision-making process. Acceptance/rejection decisions should be capable of being made by the information technology system.

Accuracy, speed, accessibility, and cost effectiveness: The most important step that can be taken to improve accuracy, speed, accessibility, and cost effectiveness is to enable registrants to enter their registrations directly into the database and to conduct their own searches. That is, registration and searching should be made available as widely as possible to end users of the registry via the internet. Doing so will: (1) improve accuracy by eliminating the risk of staff keying errors for such registrations and by applying fixed logic to produce reliable searches; (2) improve speed by permitting registrations to be completed and confirmed instantaneously upon submission, and by providing immediate search results upon submission of a request; (3) improve accessibility by making the registry available to users at any location at any time; and (4) reduce costs of operation by transferring the labor burden of data entry from registry staff to the end users. Authorization of electronic registration and searching is, therefore, imperative.

For those users who do not have electronic capability, existing modes of access should be preserved; i.e., users should continue to be able to register in person or by fax at registration centers. For paper or fax registrations, the registry staff should use the same technology system in order to eliminate the need for examination of the application before data entry and to produce the same results as produced for electronic registrants. The registry center staff should immediately return a print-out of the information that was entered into the database to the registrant for data verification.

Optimizing the use of information technology to transfer labor responsibility to the end users of the registry not only reduces the need for staff and increases cost effectiveness. Further, by eliminating the need for detailed examination of registration applications, registry staff qualifications can be reduced from highly-paid lawyers to clerical level. A modern, web-based registry can also reduce technology infrastructure by enabling registration offices to use only PCs connected to central servers at NRAST via a WAN or the internet, rather than using a full set of servers in each registration office.

The foregoing operational cost reductions will permit fees, which should be set at a level to recover the operational costs and perhaps to accrue a capital replacement fund, to be substantially reduced from current levels.

Simplicity: The registry's legal authority must simplify registration requirements, starting with eliminating the requirement for signatures. Since registration should only provide

notice and not create rights between the parties, there is no legal reason for requiring signatures. Though the real risk of fraudulent notices being registered is minimal because perpetrators cannot gain a legal advantage by doing so, such minimal risk can be countered by technology system controls on access to the system. Modern systems make it possible to identify a person who submits any application electronically.

Information requirements and forms should be simplified and made user-friendly. To the extent possible, they should reflect the requirements and screens used by online registrants so that registrants who use paper or fax do not have more complicated processes than those who register online.

Non-discriminatory treatment: Restrictions on non-client user access to registration methods used by clients should be eliminated. All types of users should be able to use all methods available for registration and searching. Non-client registrants can be permitted to use electronic and fax registration by paying fees in advance to the registry account at a bank, and then using the receipt number to log into the registry or to provide proof of payment in the fax cover page. Such systems are common in other countries. It would be simple to modify the existing system for client payments in order to accommodate non-clients.

Add-only concept: Both legal authority and the technology system should permit only the addition of information to the registry archive. That is, when an error in a registration is corrected for any reason, the correction should be added, and the information as it existed before the correction should be preserved along with the corrected information. The same is true when a registrant terminates the effectiveness of its registration. An application for termination should be added to the archive, but the registration should continue to be accessible until its normal expiration date. It is often important to determine the state of the record before a correction or termination.

Security: The only major change to security procedures that would be required by reform is to regularly back up the archive to a secure off-site facility, as there would no longer be fully-replicated databases in all registration offices.

4.2. Enforcement of Security Interests in Vietnam

4.2.1 Importance of Strong Enforcement Procedures

Security interest enforcement is a process by which a creditor, upon default by the debtor, exercises the right to sell or otherwise dispose of the property in which the security interest has been taken and apply the proceeds to satisfy the secured debt. Enforcement under a modern secured transactions system is characterized by speed and low costs. The cost of lending increases when enforcement mechanisms are weak or inefficient.

While real property mortgage foreclosures often involve a relatively slow and orderly process controlled by courts, enforcement for security interests in movables is designed to allow creditors to act swiftly against the collateral. Movable assets tend to be much more fluid than immovables, and can depreciate quickly. Experience in modern secured transactions systems shows that enforcement is most efficient and effective when the law (1) allows the parties to set out in their security

agreements the enforcement measures that the secured party may take if the debtor defaults, or (2) specifies enforcement rules that recognize the importance of expedient and low-cost enforcement.

4.2.2 Enforcement Procedures in Vietnam

Enforcement of security interests in movable property is a rare occurrence according to interviews with judges and practitioners. *The rarity of enforcement is likely a function of high costs, delays, and uncertainty of results.* While the financial institutions interviewed declined to discuss in detail their experience with enforcement, they believe that it takes far too long to enforce on collateral when a debtor defaults. Financial institutions indicated that it may take from three to 36 months to obtain judgment on a default case, and an additional one year on average to have the judgment enforced. According to banks, ineffective enforcement is largely due to the judicial system's limited resources and the complexity of the current enforcement procedures and practice.

Under Decree 165 Vietnamese law allows parties to contractually agree on what constitutes default[44] and design their own enforcement procedures. In particular, a secured creditor can take possession of the collateral, sell it through private sales, or proceed against the receivables by notifying account debtors to remit payment to the secured creditor. However, while the secured creditor has the right to possession of collateral,[45] there are some costly formalities involved such as registration of enforcement notices at NRAST.[46] Further, enforcement procedures may not begin until seven days after the registration[47] unless the value of the collateral is in jeopardy.[48] NRAST must notify other secured parties of the notice where the same property is at stake. Sale of property is limited to the time stated in the notice of enforcement.[49]

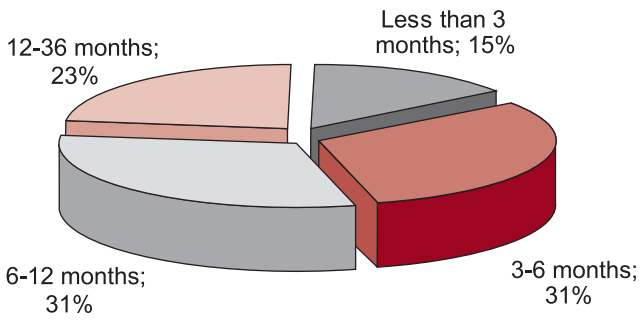
While Vietnamese laws enable out-of-court enforcement of collateral in an efficient and a speedy manner, another critical problem is that not all secured parties are treated alike. Some remedies may be available to credit sellers and suppliers that are not available to credit institutions, and vice versa. For example, credit institutions may be subject to significant restrictions in pursuing remedies that other secured parties are not required to observe. Such enforcement options for credit institutions are significantly narrowed by Decree 178 and inter-ministerial Circular 3 (23 April 2001).[50] According to these policies, contractual remedies must be pursued before any other remedies that other laws may provide. Disposition of collateral as agreed by the parties is limited to: (1) sale, (2) retention of the collateral by the creditor in satisfaction of the secured debt, or (3) auction.

In the event of sale, the debtor and creditor must agree on the price to be obtained, an occurrence that would be rare indeed. In the absence of an agreement, a third party must be retained to assess the value of the collateral.[51] As a result, auction remains as the only real option.[52] Credit institutions report that auction is unrealistic given the considerable costs, legal formalities, and uncertainty of results under the relevant law.[53] For credit institutions, the value of contractual remedies is defeated by the strict formalities required in Decree 178 and Circular 3. In essence, the Decree 165 promise of efficient remedies is channeled directly to the state-controlled auctioneer.

44 Decree165, Art. 22(5).
45 Decree 165, Arts. 23 and 29.
46 Decree 165, Art. 26.
47 Decree 165, Art. 25.
48 Decree 165. Art. 30.
49 Decree 165, Art. 30.
50 Note that enforcement procedures for secured parties other than credit institutions are governed by Circular 6 of the Ministry of Justice (28 Feb. 2002).
51 Circular 3, Art. B. VII.
52 See Decree 178, Art. 33.3, and Circular 3, Section A. II.
53 Auction procedures are governed by Decree 5 (14 January 2004).

Therefore, while the Vietnamese legal framework allows parties to agree on their own remedies and permits out-of-court enforcement, in the absence of a cooperative debtor, creditors generally conclude that they are most likely to succeed by suing the debtor, obtaining judgment, and following remedies under the procedure for enforcement of judgments. An emergency order may prevent the debtor from using or disposing of the collateral, but it rarely results in dispossession of the debtor. In any event, this procedure requires a 100% security deposit upon application and it is subject to lengthy appeal. For example, for 85% of the banks surveyed, it took longer than three months receive a court judgment and in 54% of cases it took more than six months (Figure 10).

Figure 10: Time Required to Obtain a Court Judgment

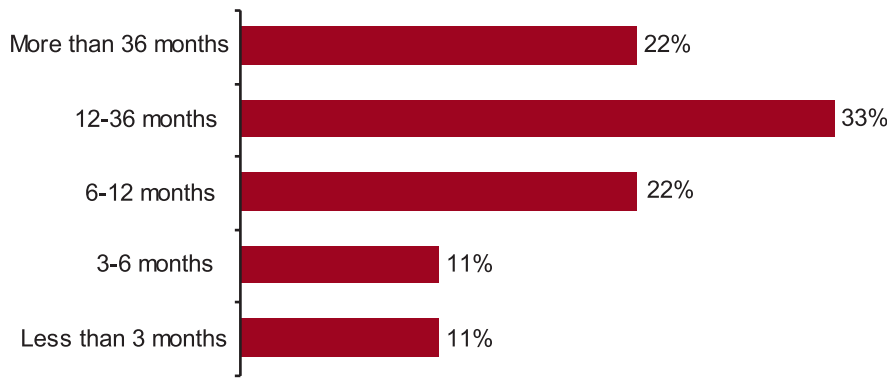


Source: IFC-VBA Financial Sector Survey.

Enforcement of any eventual judgment is also a lengthy and expensive procedure. Judgments cannot be enforced while an appeal is pending. The debtor can appeal in a process that takes months. When a final judgment is issued, enforcement may not begin until 15 days after the judgment date. Further, there is no procedure that compels the debtor to reveal his/her assets. Nearly any interested agency may intervene in the execution at any time, issuing an order to terminate the execution proceeding.

Court actions at both first instance and appeal levels may take up to one year in practice (even though the legal time limit for the two procedures is four months combined). In addition, even if the creditor has obtained a final appellate judgment, the judgment could also be subject to further review by the Supreme People's Court (at its discretion), which may further delay the enforcement. Then, several hurdles must be overcome when a court judgment is to be actually enforced by the civil judgment enforcement agency. As a result, in 55% of the cases, enforcing on a court judgment takes 12-36 months (Figure 11).

Figure 11: Time Required to Enforce a Court Judgment



Source: IFC-VBA Financial Sector Survey.

Circular 3 stipulates that local people's committees and police agencies can assist credit institutions. However, local governments and police agencies generally lack political will to assist lenders. Very few reports show that Circular 3 has helped enforcement proceedings.

If property is seized by court order prior to judgment, a fee is assessed in the amount of 5% of the value of the seized property. Additional fees are incurred if a final judgment calls for the service of the civil judgment enforcement agency.

4.2.3 Improvements with 2005-2006 Reforms

The new, reformed legal framework now provides a level playing field for all secured creditors, as the same remedies are available to credit sellers, suppliers, and credit institutions.

A major improvement is that according to Decree 163 of 2006, parties can now agree what constitutes default. In the event of default, both the Civil Code (Article 336-338) and Decree 163 preserve the consecutive order of remedies: contractual remedies must be pursued first and then auction.[54] Private sales are also allowed at market price for those assets that have a market.[55]

Contractual remedies may include sale of collateral, retention of collateral by the secured party, or other methods agreed upon by the parties.[56] Furthermore, the secured creditor has the right to proceed directly against accounts. Receivables can therefore be collected directly, and account debtors may be notified to remit payment to the secured party.[57] In addition, costly formalities such as registration of enforcement notices at NRAST have been repealed.

4.2.4 Recommendations on Enforcement Procedures

Introduce expedited judicial proceedings when out-of-court enforcement mechanisms do not resolve the issue. While the recent reforms introduced a level playing field for all secured creditors and provided efficient mechanisms for out-of-court enforcement, creditors find themselves in lengthy court proceedings when the debtor is not cooperative. To address this problem, Government of Vietnam should consider adopting simplified judicial proceedings.

Experience in many countries demonstrates that court enforcement is a significant obstacle to the use of secured financing arrangements. Too often, courts are so overworked that applications for enforcement are delayed for very long periods of time during which the collateral either deteriorates or is destroyed or disposed of by debtors. Court proceedings involve significant costs that are paid either by the defaulting debtor or (most often) by the secured creditor. Court officials, the only persons with authority to seize and sell collateral, are often overworked or have little motivation to act expediently so as to avoid loss or depreciation of collateral. Furthermore, they lack the expertise or resources to ensure that they sell the collateral at full market price.

54 Decree 163, Art. 58(1).
55 Decree 163, Art. 65.
56 Decree 163, Art. 59.
57 Decree 163, Art. 66.

In recent years, many countries have simplified the judicial process for the enforcement of secured debt. When judicial seizure is involved, summary legal proceedings limit judicial findings to the existence of agreement granting the security interest and of an event of default. In Slovakia, new summary proceedings for enforcing security interests have reduced enforcement time from 560 days to 45 days. In Spain, the introduction of enforcement through notary execution in 2003 has reduced the time for enforcing secured debt from one year to three months. Albania, Bulgaria, and Romania have also experienced positive results by recently introducing expedited court proceedings to repossess movables upon default.

The legal framework should include explicit authorization to pursue multiple remedies simultaneously, rather than consecutively, and without arbitrary obstacles. In Vietnam, the creditor must currently first refer to his agreement with the creditor and can only resort to auction proceedings or private sale if the former fails. Under modern secured transactions law, upon default, a secured creditor may pursue simultaneously or selectively these rights and remedies with respect to the collateral.

Procedures for auction, enforcement of judgments, and private remedies should be periodically reviewed and revised to reduce creditor risk, enhance creditor confidence in the enforcement of obligations, and thus increase credit opportunities for all borrowers.

Summary of Key Recommendations

5

The recent reforms to Vietnam's secured transactions legal framework are largely compliant with international best practices and provide the fundamental principles. While the new laws significantly improve upon the existing lending environment, experiences from other reformers suggest that the legal provisions need to be backed with broader institutional reforms and implementation assistance in order to maximize the impact.

To ensure that the laws do not remain only in the books and that the reform efforts yield the desired impact of increased access to credit, it is recommended that the Government of Vietnam (1) addresses the remaining areas that have not been addressed under the current laws and (2) adopts an effective implementation and monitoring strategy together with other stakeholders. In particular, following steps should be taken. They are listed in order of priority.

5.1 Reform NRAST Operations

The scope of the Government of Vietnam's proposed Law should be carefully drafted to coordinate with Decree 163.

In order to bring registry operations in line with international best practice, principles listed below should be incorporated into the law and the design of the new registry:

- Unity: The registry should provide for registration of all types of relevant interests and include security interests in movables (including fixtures), finance leases, long-term operating leases, and the sale of secured sales contracts and liens in movables.
- Limited purposes: NRAST should ensure that registration requirements serve only the purposes of registration and that extraneous information is not required.
- Rule-based decision-making: Acceptance and rejection standards of registration and for conduct of searches must be concrete, specific, and limited.
- Accuracy, speed, accessibility, and cost effectiveness: The most important step to improve accuracy, speed, accessibility, and cost effectiveness is enabling registrants to enter their registrations directly into the database and eliminates the need for keying by registry staff. Electronic registration is imperative. For paper or fax registrations, a print-out of the information that registration office entered into the database should be returned to the registrant immediately for data verification.
- Simplicity: The registry's legal authority must simplify registration requirements and make

forms more user-friendly. A first step is to eliminate the requirement for signatures.

- Non-discriminatory treatment: Eliminate restrictions on non-client user access to registration methods used by clients. All types of users should be able to use all methods available for registration and searching.
- Add-only concept: Both legal authority and the technology system should permit only the addition of information to the registry archive. That is, when an error in a registration is corrected for any reason, the correction should be added, and the information as it existed before the correction should be preserved along with the corrected information.
- Security: The archive should be regularly backed up to a secure off-site facility.

5.2 Build Capacity in the Financial Sector

With the reformed legal framework and soon-to-be-modernized collateral registry, there is a huge potential for more asset-based lending. To realize this potential and to take advantage of new laws, the financial sector needs to build capacity, learn risk management techniques, and structure new products. The benefits of the new, reformed environment should be explained through specialized workshops, and seminars under the leadership of financial sector constituencies such as the State Bank of Vietnam or Vietnam's Bankers Association. There should also be a forum where information and expertise is exchanged on a periodical basis.

5.3 Monitor Implementation of the Laws, Fine Tune Shortcomings, and Streamline Remaining Legal Issues

While there remain a number of areas in the laws that can be further streamlined, no additional decrees are necessary. Creditors report that they prefer to have secured transactions rules combined into a single measure. If circulars are required pursuant to Decree 163, they must refrain from adding requirements or restrictions on parties' freedom to dispose of their property rights as they choose. The provisions of a circular must under no circumstances contradict or detract from the rights and opportunities granted in the Civil Code or Decree 163.

The Civil Code and Decree 163 are comprehensive; however, the following areas within the scope of Decree 163 should be clarified or included in order to benefit the lending environment:

- *Ensure a secured creditor's right to proceeds upon the sale or other disposition of collateral.*
- *Adopt a comprehensive and commercially rational order for prioritizing secured claims against non-consensual claims.*
- *Include explicit authorization to pursue multiple enforcement remedies simultaneously, rather than consecutively, and without arbitrary obstacles.*
- *Introduce expedited judicial proceedings if out-of-court enforcement mechanisms do not resolve the issue.*
- *Periodically review progress under the new Civil Code and Decree 163.* The Government of Vietnam should systematically monitor the implementation of the new laws in practice. The review should provide meaningful opportunities for creditors and entrepreneurs to voice problems with the legal framework, if any.
- *Procedures for auction, enforcement of judgments, and private remedies should be periodically reviewed and revised to reduce creditor risk, enhance creditor confidence in the enforcement of obligations, and thus increase credit opportunities for all borrowers.*

Appendix A:
Key Secured Transaction Legislation in Vietnam

Date	Measure	Subject
11/19/1999	Decree 165	Secured transactions
12/29/1999	Decree 178	Application of secured transactions to credit organizations
5/10/2000	Decree 08	Registration of secured transactions
4/23/2001	Circular 03	Loan enforcement for credit organizations
2/5/2001	Decree 16	Finance leases
1/9/2002	Circular 01	Guidelines on registration
2/22/2002	Circular 04	Finance lease registration
2/28/2002	Circular 06	Guidelines on Decree 165
10/25/2002	Decree 85	Amendments to Decree 178 (12-29-1999)
5/19/2003	Circular 07	Guidelines on Decree 178 (12-29-1999)
1/14/2004	Decree 05	Auction procedures
1/14/2004	Ordinance 13	Execution of civil judgments
6/15/2004	National Law	Bankruptcy
9/6/2004	Decision 1096	Factoring
05/19/2005	Decree 65	Amendments to Decree 16 (2001) on finance leases
6/14/2005	National Law	Civil Code
6/14/2005	National Law	Commercial law
06/12/2005	Circular 09	Finance lease registration (replacing Circular 4 of 2002)
09/28/2006	Circular 06	Guidelines on registration (replacing Circular 1 of 2002)
12/29/2006	Decree 163	Decree on Secured Transactions (replacing Decrees 165, 178, et.al.)
05/17/2007	Decree 03	Guiding Registration of secured transactions (amending and supplementing Decree 06 in 2006)
05/17/2007	Decree 04	Guiding registration of installment purchase contract, lease and finance lease contract, sale of debt (replacing Decree 09 in 2005)

Appendix B:
Survey of Lending Practice in Vietnam

IFC, in partnership with Vietnam Bankers' Association, selected MCG Management Consulting, a local consulting firm, to conduct a financial sector survey between October and December 2006. This survey captures baseline data regarding private sector lending practices in order to measure and monitor the legal reforms' progress and impact.

Questionnaires were sent to all 89 bank and non-bank financial institutions (NBFIs) in Vietnam. Thirty-five completed questionnaires were returned. After raw data was analyzed, 22 banks and NBFIs were selected for face-to-face interviews to share detailed information on general lending practice. Below is a list of financial institutions that responded to the survey and those that were interviewed.

Summary of Questionnaires Sent and Received

Types of financial institutions	Estimate lending market share (%)[58]	Questionnaires sent	Responses received	Representation of market share of survey respondents (%)
State-owned commercial banks (SOCBs)	68%	6	5	56%
Foreign and joint venture banks (FBs and JVBs)	16%	32	5	2.5%
Private joint-stock commercial banks (JCBs)	16%	34	19	9%
Financial leasing companies and finance companies (LCs and FCs)	N/A	16	5	N/A
People's Credit Fund (PCF)	N/A	1	1	N/A
Total	**100%**	**89 (100%)**	**35 (39%)**	**67.5%**

In terms of client base, the questionnaires revealed that:

- SOCBs have the largest market share and are offer commercial loans to state-owned enterprises as well as domestic private firms, including SMEs.
- JSBs, with the second largest market share, lend primarily to small and medium enterprises. Their lending practice is similar to that of SOCBs.
- FBs, branches of foreign banks, mainly serve foreign-invested enterprises. They mainly offer commercial loans without collateral since they basically extend the loan to clients of their offshore head office. That offices manages client relationships as well as collateral on a global/regional basis. Their lending to Vietnamese SMEs have been limited in scope and size.
- LCs and FCs, non-bank financial institutions, have a different product line than banks. All FCs are subsidiaries of large, state-owned groups of companies and serve internally within the group and its industry. As such, their lending practice is not fully commercial; SME clients are not their focus. LCs, though, also target SMEs by providing only equipment leasing.

58 Vietnam Banking Sector Report - Vina Capital October 2006.

List of Financial Institutions that Responded to the Survey

No.	Name of Institution	Address
1	Agribank Leasing Company II	422 Tran Hung Dao, Dist 5 HCM city
2	An Binh Joint Stock Commercial Bank	Dien Bien Phu, Dis. 1, Ho Chi Minh city
3	Asia Commercial Bank (ACB)	442 Nguyen Thi Minh Khai, Dist 3, Ho Chi Minh
4	Bac A Joint Stock Commercial Bank	27 Hang Dau Hoan Kiem Hanoi
5	Bangkok Bank PCL Hanoi Branch	41B Ly Thai To Street Hoan Kiem District Hanoi
6	Bank for Foreign Trade of Vietnam (VCB)	198 Tran Quang Khai Hanoi
7	Bank for industry and commerce (ICB)	108 Tran Hung Dao Hanoi
8	Bank of Investment and Development of Vietnam (BIDV)	191 Ba Trieu, Hanoi
9	BIDV Leasing Company	12th floor, 191 Ba Trieu Hoan Kiem Hanoi
10	Far East National Bank (FENB)	2A-4A, Ton Duc Thang, HCM city
11	Global Joint Stock Commercial Bank (G-Bank)	21 Phan Chu Trinh, Ha Noi
12	Habubank	B7 Giang Vo Ba Dinh Ha Noi
13	Hong Kong Shanghai Bank Corporation (HSBC), Ho Chi Minh branch	235 Dong Khoi, Ben Nghe, Dist 1, Ho Chi Minh
14	House Development Bank (HDB)	33 - 39 Pasteur, Dis. 1, Ho Chi Minh city
15	Housing Bank of Mekong Delta (MHB)	9 Vo Van Tan, Dist 3, Ho Chi Minh city
16	Kien Long Joint Stock Commercial Bank	44 Pham Hong Thai, Vinh Thanh Van, Rach Gia
17	My Xuyen Rural Joint Stock Commercial Bank	248 Tran Hung Dao, Long Xuyen city, An Giang province
18	Nam Viet Joint Stock Commercial Bank	123 Mac Cu, Vinh Thanh, Rach Gia
19	People's Credit Fund	193 Ba Trieu Hoan Kiem Hanoi
20	Petro Vietnam Financial Company (PVFC)	72 Tran Hung Dao Hanoi
21	Sacombank	278 Nam Ky Khoi Nghia, Dist 3, Ho Chi Minh city
22	Sacombank Leasing Company	87A Ham Nghi, Dist. 1, HCM city
23	Sai Gon Bank for Industry and Trade (Sai Gon Bank)	2C Pho Duc Chinh, Dist 1, Ho Chi Minh city

No.	Name of Institution	Address
24	Sai Gon-Ha Noi Joint Stock Commercial Bank	138,3/2, Hung Loi, Ninh Kieu, Can Tho
25	Saigon Commercial Bank (SCB)	193 - 203 Tran Hung Dao, Co Giang, Dist 1, Ho Chi Minh
26	SEA Bank	16 Lang Ha, Dong Da, Hanoi
27	Standard Chartered Bank	49 Hai Ba Trung Hanoi
28	Sumitomo-Mitsui Banking Corporation	5B Ton Duc Thang, Q1, HCM city
29	Techcombank	15 Dao Duy Tu Hoan Kiem Hanoi
30	Thai Binh Duong Joint Stock Commercial Bank (TBD)	340 H-K, Hoang Van Thu, Tan Binh Dis.
31	Vietcombank Leasing Company (VCB Leaco)	10 Thien Quang Str., Hai Ba Trung Dist., Hanoi
32	Vietnam Asia Joint Stock Commercial Bank	115-121 Nguyen Cong Tru, Dis.1, Ho Chi Minh city
33	Vietnam Bank for Social Policies (VBSP)	78 Truong Chinh Hanoi
34	Vietnam Export-import commercial joint stock bank (Eximbank)	7 Le Thi Hong Gam, Dis.1, Ho Chi Minh city
35	VP Bank	8 Le Thai To, Hoan Kiem, Ha Noi

List of Financial Institutions Interviewed

No.	Name of Institution	Address
1	ACB Sai Gon	442 Nguyen Thi Minh Khai, Dist 3, Ho Chi Minh
2	Agribank Leasing Company II	422 Tran Hung Dao, Dist 5 HCM city
3	Bangkok Bank Hanoi	41B Ly Thai To Street Hoan Kiem District Hanoi
4	Eximbank Hanoi	19 Tran Hung Đao, Dist. Hoan Kiem, Hanoi
5	Eximbank HCM	7 Le Thi Hong Gam, Dis.1, Ho Chi Minh city
6	Far East National Bank HCM	2A-4A Ton Duc Thang Street, District 1 Ho Chi Minh City
7	Habubank Bac Ninh	119 Tran Phu, Tu Son, Bac Ninh
8	Habubank Hanoi	B7 Giang Vo Ba Dinh Ha Noi
9	House Development Bank (HDB)HCM	33 - 39 Pasteur, Dis. 1, Ho Chi Minh city
10	Housing Bank of Mekong Delta (MHB)Hanoi	41A Ly Thai To - Dist Hoan Kiem- Hanoi
11	Northern Asia Bank Hanoi	27 Hang Dau, Hoan Kiem, Hanoi
12	Pacific Bank	340 H-K, Hoang Van Thu, Tan Binh Dist.
13	Petro Vietnam Financial Company (PVFC) HCM	208 Nguyen Trai - Dis. 1 - Ho Chi Minh city
14	Sacombank Hai Duong	144 Thong Nhat, Le Thanh Nghi, Hai Duong city
15	Sacombank Leasing	87A Ham Nghi, Dist 1, HCM city
16	Sacombank Sai Gon	278 Nam Ky Khoi Nghia, Dist 3, Ho Chi Minh city
17	Saigon Bank HCM	2C Pho Duc Chinh, Dist 1, Ho Chi Minh city
18	SEA bank Hanoi	16 Lang Ha, Dong Da, Hanoi
19	Techcombank Hanoi	15 Dao Duy Tu Hoan Kiem Hanoi
20	Techcombank Sai Gon	24-26 Pasteur, Dist. I, Ho Chi Minh city
21	Vietnam Asia JSB HCM	115-121 Nguyen Cong Tru, Dis.1, Ho Chi Minh city
22	VP bank Hai Phong	31-33 Pham Ngu Lao, Luong Khanh Thien, Dist Ngo Quyen, Hai Phong

Appendix C:
Key Features of a Modern Secured Transactions System

Much business wealth is in the form of tangible and intangible movable property. Laws and institutions that facilitate the use of this property as security for debt yield the most benefits on the economy.

In the early 1950s, the United States became the first country to develop a uniform law that permitted using movable property as security interest. Under Article 9 of the Uniform Commercial Code (UCC), a single universal security interest replaced a multitude of traditional security devices such as pledge and chattel mortgages. With the exception of a few specific types of collateral, security interests in all movable property, tangible or intangible, present or future, are all now subject to this single framework. This uniform approach also extends to all types of secured transactions, including ownership-based title financing techniques such as conditional sale, retention of title, and financial leasing, which are treated as functional equivalents of secured transactions and subject to the same publicity and priority rules as all other security interests. The UCC approach is followed in large part by many provinces in Canada and has proven highly effective in commercial practice. In 2000, New Zealand completely revamped its English law-based security law in favor of a unified secured transactions law regime equipped with a modern publicity system.

Over the past 10 years, a number of Central and Eastern European countries such as Albania, Bulgaria, Bosnia, and Romania have embraced the key concepts of the North American model. In Asia, recent reforms in Cambodia followed the same path and legislative proposals are underway in many other countries.

Regional and international organizations also drafted model laws and legislative guides aimed at helping their member countries to establish simplified and effective modern secured transactions law regimes. There remain substantial differences between such prototypes; however, general consensus is that secured transactions laws need to be placed in a single conceptual framework in order to systematically address issues relating to the creation, perfection, and enforcement of security interests.

Following is a brief discussion of these widely accepted best-practice principles.

C.1 Principles that Govern the Legal Framework for Secured Transactions

C.1.1 Scope and Creation of Security Interests

A central feature of a modern secured transaction legal system is its focus on efficiency and functionality. To that end, it is widely accepted that a unified conceptual approach to secured transactions yields the most efficient outcomes. In this way, the law can accommodate diversity while maintaining a coherent structure by focusing on the substance, and not the form, of secured transactions. All transactions that create a real right in property in order to secure an obligation should fall within the scope of the law.

A secured transactions law adopting such a unified conceptual approach has several key components that will be discussed in detail:

- Broad scope of permissible collateral
- General description of collateral
- Future-acquired collateral
- Proceeds of the collateral
- Freedom of contract
- Ease of securities interests

Broad Scope of Permissible Collateral: Universal Security Interest

The secured transactions law should provide for a single, unitary concept of "security interest" that is defined as a real right to movable property (collateral) granted by one person (debtor) to another person (secured creditor) in order to secure an obligation (quantifiable in money) owed by the debtor or a third person to the secured creditor. The "security" aspect is the right of the creditor to rely on the movable property as an alternative source of recovery should the debtor fail to discharge his/her obligations to the secured party.

The universal security interest has the flexibility of allowing security interests to be created in movable property of all kinds, tangible or intangible, present or future. As set out in the Universal Commercial Code (UCC) of the United States, the universal security interest concept broadly defines a security interest as "an interest in personal property or fixtures which secures payment or performance of an obligation."[59] As stated above, the uniform approach is also followed by Canada and New Zealand and transitional economies such as Albania.

Universal security interest offers the following advantages.

1. A single security device can be used to create security interests in all types of movable property, tangible or intangible, present or future.
2. A single set of rules is applicable to the creation, perfection, and enforcement of security interests.
3. It facilitates the establishment of a central publicity system that helps potential creditors determine the priority status of their security interests prior to lending.

General Description of Collateral

The success of secured lending frequently depends on the parties' ability to define collateral in general terms. The collateral description must not be unclear or misleading, but rather the description need not specifically identify the collateral. For example, the collateral description "all inventory of the debtor" is clear (provided that the term "inventory" is well-defined in the law), even though the description does not specifically identify a single piece of inventory. Examples of financing techniques that depend on the ability to describe collateral generally include:

59 UCC 1-201(37).

- Inventory financing for shops, department stores, and other dealers of goods.
- Financing for agriculture based on crops and livestock as collateral.
- Receivables financing where collateral is a changing set of accounts that are paid by a changing set of customers.

General collateral descriptions have been an essential feature of secured lending in the US and Canada for several decades. More recently, many transition countries that have adopted best-practice secured lending principles have incorporated the ability to describe collateral generally in security agreements and notices filed in secured transactions registries or filing offices.

Future-Acquired Collateral

Commercial finance often requires securing an obligation with property that may be acquired by the debtor in the future, after the conclusion of a security agreement or other agreement creating security in movable property. Examples of the economic value of future-acquired collateral are similar to those discussed for generally described collateral:

- Inventory financing for shops, department stores, and other goods dealers is efficient only when a pledge agreement, consignment agreement, or other security agreement effectively extends to inventory acquired after the conclusion of the agreement.
- Receivables financing is most useful when an agreement may effectively extend to receivables that are created after the conclusion of the agreement.
- Financing for agriculture based on crops and livestock as collateral is efficient only when the agreement that creates security in crops or livestock may effectively extend to crops and livestock produced after the conclusion of the agreement.

The use of future property as security is not permitted by traditional law. New agreements or amendments to initial agreements are required every time new collateral is acquired by the debtor. The consequences of such a system are that:

- If a registry is created for security interests, new registrations or registration amendments are required as new property is acquired by the debtor.
- Close supervision of the debtor is required.
- The transaction costs incurred may often be expensive, and credit could be denied.

Therefore, it is important that modern secured financing laws expressly permit the use of collateral that will be acquired in the future. "Future collateral" provisions are common in the laws of countries that have attempted to modernize secured lending practice. For example, legislative text on future-acquired collateral in the United States Uniform Commercial Code provides that "a security agreement may create or provide for a security interest in after-acquired collateral."[60] Future collateral is also expressly permitted in countries such as Canada, New Zealand, Albania, Belarus, Bulgaria, Hungary, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Poland, Romania, Russian Federation, Slovakia, and Ukraine.

60 UCC 9-204(1).

Proceeds of the Original Collateral

Almost all modern secured transaction laws provide that a security interest automatically extends to proceeds of the collateral. "Proceeds" means property that is acquired by the debtor as a result of disposition of the collateral or as compensation for its loss or damage. The right to assert a security interest in proceeds is particularly important in inventory financing where there is an express or implied power given to the debtor to sell the original collateral. The secured party knows that the original collateral is to be sold and, consequently, looks to the proceeds (in the case of inventory or cash) in place of the original collateral. Proceeds are also important for goods-in-process (e.g., goods being manufactured) and for agricultural products (e.g., seeds that are transformed to wheat, then to flour, then into cash). While a security interest in proceeds is an extension of the security interest in the original collateral, it may be necessary to amend a registration to include the kinds of property that are claimed as proceeds.

Freedom of Contract

In a modern secured transactions regime, the secured creditor is responsible for determining such matters as the value of the collateral and the acceptable ratio of collateral value to the amount of the obligation. That is, the law gives parties freedom to come to terms in their agreement that protect their interests, and it considers the relative rights of other interests in the collateral.

Most modern secured transactions systems permit flexibility that extends beyond the form of transactions. That is, laws reflect the needs of the parties to transactions rather than requiring commercial activity to conform to legal mandates.

Ease of Creating Security Interests

Modern secured transactions laws permit parties to create a security interest as a real right in movable collateral by agreement. Publication by registration provides notice of the existence of the security interest and establishes the enforceability of the security interest against third parties.

The ease of creating security interests also depends on minimal formal requirements. Written agreement signed by the debtor and identifying the collateral and the secured obligation are sufficient - no special terminology, forms, or notarization should be required. Importantly, anyone may give security in movables and any person may take security in movables. Security over future assets or a changing pool of assets may be created by agreement without the need for any further acts.

C.2 Priority of Security Interests

Perfection and priority rules promote commerce by reducing risk. Modern secured transactions laws are designed to help the creditor assess risks through clear and comprehensive priority rules and effective publicity mechanisms. In this way, the existence of prior interests in the collateral can be disclosed and order of priority can be established.

Priority rules establish the order in which several claims secured by interests in the same collateral are to be satisfied from proceeds of the collateral when the debtor defaults. Priority rules must be:

- clear and precise so that a creditor and other persons dealing with the debtor can determine with a high degree of certainty the legal risks associated with granting secured credit;
- comprehensive in scope; and
- capable of resolving conflicts not only among security interests but also between security interests and non-consensual liens to which the law may give preferential treatment.

Clear and detailed priority rules should be defined in the country's secured transactions law - not through a proliferation of other laws, regulations, and rules. The secured transactions law should therefore consist of a basic priority rule and a series of specific rules designed to serve overriding commercial or social purposes.

C.2.1 Basic Priority Rule: "First in Time, First in Priority"

The basic priority rule is "the first to register or otherwise perfect has priority," or more familiarly, "first in time, first in priority." That is, the first creditor to register a security interest or to perfect it by other means, e.g., by possession or control, has priority over creditors who register or perfect at a later time with respect to the same collateral, and over creditors who do not perfect their security interests.

Neither the creation date of the competing security interests nor knowledge of prior unregistered security interest in the collateral should be relevant in determining priority, except as between unperfected security interests.

C.2.2 Purchase-Money Security Interest

Modern secured transactions laws use "super-priority" rules to promote sales credit, particularly in equipment, inventory, livestock, and consumer goods. A creditor with "super-priority" may enjoy priority over previous secured creditors, even though the latter may have registered first. "Super-priority" rules are created in favor of creditors that lend money for the purchase of specific property (provided that the debtor actually uses the credit to complete the purchase). Such creditors are referred to as "purchase-money creditors". Without super-priority status, a purchase-money creditor would be unwilling to supply secured credit when the property buyer had previously granted a general security interest in all of its existing and future-acquired property or in the kind of property that the buyer wishes to obtain and a registration relating to that security interest had been effected.

C.2.3 Buyers of Collateral

When a buyer acquires collateral, the general rule is that the collateral is subject to a prior security interest. The rationale for this policy is that the buyer, like all third parties, should search the secured transactions registry records and see that the security interest existed. However, there are following are exceptions to this rule.

Ordinary Course of Business. A buyer or lessee of tangible property, from a seller or lessor who has sold or leased the property in the ordinary course of his/her business, takes the collateral free of a security interest in the property given by the seller or lessor. The secured creditor loses its interest in the original collateral, but obtains an automatic security interest in proceeds received by the debtor.

Buyer of Low-Value Consumer Goods. Buyers of low-value consumer items are not expected to incur the costs and inconvenience of searching the secured transactions registry. They are given priority as long as they buy the items without actual knowledge of security interests in them.

Negotiable Collateral. When negotiable collateral is involved (e.g., money, negotiable instruments, or securities), the secured creditor can choose either to take possession of the collateral or register its security interest. However, this choice will affect the priority status of the interest. If the security interest is registered and the negotiable collateral is left in the debtor's possession, any collateral negotiation that results in the buyer (transferee) of the collateral acquiring a right to it (e.g., as a holder-in-due course of a bill of exchange) will result in loss of the security interest. If the secured party decides to take physical possession of the collateral, its interest is fully protected against any possible subsequent interest in it.

C.2.4 Treatment of Non-Consensual Liens

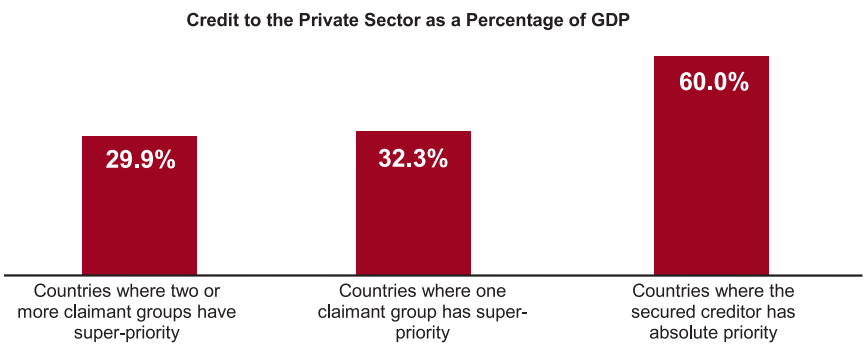
In many jurisdictions, public policy gives preferential treatment (super-priority) to certain categories of claimants (e.g., tax authorities, workers, judgment creditors, and insolvency administrators) whose claims arise without the debtor's consent. Such claims, generally referred to as "liens," are granted the status of security interests by virtue of a statute or judicial process and may sometimes be given super-priority rights over consensual secured claims.

A proliferation of non-consensual liens with super-priority creates uncertainty and risks for existing and potential secured creditors when the liens cannot easily be discovered. If non-consensual liens were not publicly disclosed, it would be difficult or impossible for secured creditors assess the risks associated with granting secured credit.

Modern secured transactions systems best facilitate credit markets and business activity where (1) liens are fully disclosed through publication, and (2) liens are not granted super-priority status over prior secured creditors. To this end, best-practice disclosure calls for all non-consensual liens to be registered in the secured transactions registry. For example, in the United States, tax liens must be registered in the general secured transactions registry in order to establish their priority status in the collateral. Only those tax liens which are registered prior in time have priority over consensual security interests. While few jurisdictions require judgment creditors or insolvency administrators to register notices of their claims with the security registry, such claims must be disclosed through other appropriate publicity mechanisms in order to be ranked ahead of a later perfected security interest.

Globally, 52 countries provide the secured creditor with absolute priority. Another 37 provide super-priority to one other type of claimant (mainly taxes or workers) and 45 provide super-priority to more than one other type of claimant. The effect on credit markets is significant: for each additional type of claimant that ranks ahead of secured creditors, the amount of credit to private businesses falls on average by 30 percentage points (Figure A).

Figure A: Access to Credit is Greater when Secured Creditors Have Priority



Source: World Bank Doing Business project database

C.3 Principles that Govern the Institutional Framework for Secured Transactions

C.3.1 Publicity for Security Interests: A Unified, Centralized Registry

Under modern commercial transactions, security interests are created on a non-possessory basis, meaning that the borrower keeps and uses the collateral that has been offered as a security to a lender. This is a critical feature of modern finance: a merchant must have possession of inventory to market it; a contractor must have use of equipment to perform contracts; and an agricultural producer must have machinery to plant and harvest crops.

In many cases, third persons may be deceived by a debtor's possession or control of movable property. How can a prospective lender or a buyer determine if someone else has an interest on a piece of property? Publicity of information relating to security interests provides a solution to such problems - third persons can discover prior interests in movable property when such information is publicly available. Therefore, the essential value of publication is that it helps creditors to assess and avoid risk. It discloses the existence or potential existence of the interests in the property to persons who intend to purchase or to take security interests in movable property.

All modern secured transactions registries adopt a registration method commonly known as "notice filing" rather than "document filing". Unlike a document-filing registry, a notice-registration system does not require the actual security agreement to be filed or even tendered to the registry. Instead, secured parties submit registration information in a standardized format. This information is nothing more than the basic factual particulars needed to alert third parties to the potential existence of a security interest in identified items or general kinds of movable property of the named debtor. The underlying agreements are not placed in the registry records.

Notice-registration recognizes that while priority of a security interest may be determined by the date it is affected, registration by itself does not create rights. Instead, it gives notice of the existence or potential existence of an interest held or to be acquired by the identified secured party in the identified debtor's items or kinds of movable property. An important consequence is that it is not the responsibility of the registrar to determine whether or not a valid security agreement exists between the persons named in the registration as secured party and debtor or that the registration has been authorized by the debtor.[61]

The notice-filing concept developed with the first modern secured transactions laws established in the 1950s in the United States. Other countries such as Albania, Bosnia, Cambodia and Romania that have adopted modern secured transactions laws have also adopted some version of notice filing.

C.3.2 Principles that Govern Notice-Filing Registries

Over the past 50 years of experience with notice-filing registries, first in the west and in more recent years in emerging markets, a set of widely accepted principles for such registries has evolved. Only in the past 10 to 15 years, though, has it been possible to realize the full value of the principles with

61 However, many systems contain measures to address situations where a registration does not represent an existing or potential relationship between the parties identified in it and the person named as debtor requires such registration to be discharged.

the use of modern information and communications technologies. The internet and modern information technology systems enable the full application of best-practice principles for the benefit of financers and buyers of movable property.

Widely accepted features of notice-filing registries are as follows:

Unity: The registry should include notices of all types of security interests and liens in all types of movable property of all types of securing parties, and geographic coverage should include the entire country. There should be one set of rules applied to all types of security interests and liens with regard to registration and its effect on priority.

Limited purposes and information: The registry should include only information that is necessary to give notice of a security interest in identified movable property and to establish the priority of the secured party in the property. It should not include information that is not necessary to alert a potential creditor or buyer of the existence of a security interest; i.e., a notice should not include information regarding the nature or amount of the secured obligation or the value of the collateral.

Rule-based decision-making: The registry system should not require human discretion. It should eliminate random notice acceptances or rejections and determinations of what information to report on a search.

The most effective way to remove human discretion and error is to use a technology system that applies fixed rules in the form of system edits of data fields and fixed-search logic, and uses check sums in registration. The fixed rules must yield predictable results, so all users (both registrants and searchers) must know the rules.

Accuracy: The registry design should push data entry into the end user's hands in the vast majority of cases, thereby eliminating the possibility of registry staff entering the wrong data. That can be done by making online registration an attractive option. Likewise with entering search criterion, to assure that data entry is correct, the registry technology system should require verification before the user commits a notice to the database. Finally, if registry staff must enter certain notices from paper, the staff should immediately print out the entered data and give it to the end user who delivered the paper to the registry office. The user should then confirm the data's accuracy or correct the data immediately.

Speed of entry and timeliness of information: The registry technology system should immediately accept or reject a notice upon user submission, without the need for registry staff intervention in the case of registrations submitted via the internet. In cases where registry staff must enter information from a paper notice, entry should be done immediately upon receipt of the notice. Information should become available to searchers immediately upon its submission.

Accessibility: The registry should be available for users to register and search 24 hours a day, seven days a week via the internet. For users that do not have access to the internet, the registry should accommodate receipt of notices by a variety of means such as post, fax, or personal delivery.

Simplicity: The registry technology system should use simple, user-friendly interfaces for users that register notices via the internet. For other users, forms should be logical and limited to those items

that are necessary for registration. Registration should not require formalities such as signatures and notarization. Opportunities for error and the need for specialized expertise such as lawyers should be minimized.

Cost effectiveness: The system should be cost effective in terms of notice preparation, notice presentation, and the fees paid for registration and searching. Costs for legal review or notarial acts should be eliminated by eliminating requirements for those functions. The registry's operational, overhead, and transactional costs should be kept as low as possible by maximizing the use of technology and minimizing staffing and archiving needs. Registration fees should be assessed per notice, and should be set to recover only the costs of operation and capital replacement, so as not to be a burden on commerce.

Non-discriminatory treatment: The registry should make no distinction between regular and one-time users in the modes of registration that are available. All users should be able to use the internet, as well as other media, to register notices and search the archive.

Security: Security refers to that of (1) data against electronic tampering, (2) disaster recovery, and (3) physical security of the registry facility. The registry's users must have confidence in its continuity of operation and must be able to rely on its information. Therefore, the registry must secure itself from disruption of operations and protect the integrity of its data.

C.4 Enforcement of Security Interests

Security interest enforcement is a process by which a creditor, upon default by the debtor, exercises the right to sell or otherwise dispose of the property in which the security interest has been taken and apply the proceeds to satisfy the secured debt. A speedy, effective, and inexpensive enforcement procedure is essential for creditors to realize the full value of the collateral.

Experience in modern secured transactions systems shows that enforcement is most efficient and effective when the parties to a security agreement are given two powers, subject to reasonable limitations:

- the power to determine their rights and remedies prior to default by the debtor; and
- the power of secured creditors to employ "self-help enforcement," i.e., to initiate and execute enforcement measures, such as seizure and sale of tangible collateral and collection of accounts, without the involvement of the courts or public officials.

Enforcement under a modern secured transactions system is characterized by speed and low costs. Real property mortgage foreclosures often involve a relatively slow and orderly process controlled by courts.[62] Movable assets, however, tend to be much more fluid than immovable, and can depreciate

62 In the United States, real property mortgage foreclosures are governed by a different body of law than that of security interest enforcement in movable collateral. Many states only allow judicial foreclosures of real estate mortgages, which typically require court-supervised valuation and liquidation. Reform efforts in recent years advocate for private enforcement of real estate mortgages in order to reduce "delays and inefficiency associated with foreclosure by judicial action." A number of states now allow secured creditors to conduct real estate foreclosure sales outside the judicial process (the so-called "power of sale foreclosure"). Many Canadian provinces also permit power of sale foreclosures.

quickly. As such, enforcement for security interests in movables is designed to allow creditors to act swiftly against the collateral. Modern secured transactions law either: (1) allows the parties to set out in their security agreements the enforcement measures that the secured party may take if the debtor defaults, or (2) specifies enforcement rules that recognize the importance of expeditious and low-cost enforcement. Generally, the agreement or the regulatory law gives the secured party a range of rights and powers, including seizure and sale of tangible collateral and direct collection of accounts. At the same time, the law imposes reasonable limits on the exercise of a secured creditor's rights and remedies in order to protect the interests of the debtor and other parties with interests in the collateral. In this way, lenders can be assured of recovering their loaned money on fair terms and with minimal delays and cost, and are more likely to extend credit to businesses.

C.4.1 Right to Define by Contract What Constitutes "Default"

The power to determine what constitutes default is one of the most important aspects of the parties' powers in a security agreement. This agreement defines their respective rights and remedies if the debtor defaults on the loan.

For example, Article 9 of the United States Uniform Commercial Code does not define what constitutes "default," but leaves the definition to agreement by the parties. More than 40 other countries, including Australia, Canada, Denmark, Finland, France, Singapore, Thailand, and the United Kingdom have similar systems. In these countries, debtor default can trigger a secured creditor's rights and remedies with respect to the collateral.

If the parties to a security agreement are not given the freedom to agree on what constitutes default and, under a narrow legal definition, default only covers failure of payment when due, the creditor is precluded from taking enforcement measures against the collateral even when there is an imminent threat of non-payment or the collateral is placed in jeopardy. In such cases, a secured creditor's remedy is limited to suing the debtor on the ground of breach of contract (much like an unsecured creditor), and the creditor thus loses a key benefit of the security.

C.4.2 Secured Creditors' Rights and Remedies after Default

Under modern secured transactions law, upon default, a secured creditor may simultaneously or selectively pursue the following rights and remedies with respect to the collateral:[63]

Right to Take Possession of Collateral

Upon default, a secured creditor has the right to take possession of the collateral. If the debtor does not voluntarily surrender the collateral, the creditor can repossess the collateral through self-help or judicial process.

Self-help enforcement against tangible collateral

A secured creditor may take possession of the collateral by means of self-help without consent by the debtor as long as there is no "breach of the peace". Breach of the peace includes entering the

63 The following discussion does not cover a secured creditor's default remedies in consumer credit transactions, which are often subject to different and more stringent regulations in many modern secured transactions systems.

premises of the debtor without permission, resorting to physical violence or intimidation, or being accompanied by a law enforcement officer when taking possession or confronting the debtor. The no-"breach of the peace" requirement is based on the policy that the assertion of private contractual rights must be subordinated to societal interest in avoiding highly abusive and disruptive conduct.

As a practical matter, creditors attempt to use informal workouts to recover debt whenever feasible; self-help and other seizure and sale mechanisms, especially in situations where all of a debtor's assets are pledged, effectively stop the debtor's business operation. Stopping the operation could drive the debtor into bankruptcy, a result not necessarily desired by the creditor. However, there are many situations in which a workout is not realistic. In such cases, enforcement of the security interest through seizure and sale of the collateral is the only commercially realistic course. In these cases, self-help is the most efficient method of enforcement. It is the most commonly used enforcement method by creditors in countries including Australia, Canada, United States and New Zealand, and has recently been introduced in other countries such as Latvia. The threat of self-help enforcement as a legal remedy also makes the debtor more willing to cooperate and gives the lender more leverage in negotiating workout arrangements with the debtor.

When the collateral is accounts receivable, and physical repossession is not possible, a secured creditor has the right to notify account debtors to pay the secured creditor directly. Unless otherwise agreed by the parties, a secured creditor is authorized by statute to notify account obligors and collect on the accounts only after default. However, parties may by agreement permit such notices and direct collection prior to default. If an account debtor fails to pay the secured creditor in response to such a notice, the secured creditor has the right to enforce the payment obligation. If the receivables themselves are secured, the creditor may enforce the debtor's security interest in the collateral. Several countries, particularly transition countries such as Albania, Bulgaria, Poland, and Ukraine, have recently introduced non-judicial rights to collect on accounts receivable or to dispose of intangible property over which the secured creditor has control.

Possession through judicial process

A secured creditor must resort to the judicial process if the collateral cannot be possessed peacefully (either with debtor cooperation or by means of self-help). A court order may be issued without ruling on the merits of the case and a court officer will then seize the collateral and deliver it to the creditor for disposal. Alternatively, the court order may require a peace officer to accompany the secured party when seizure occurs in order ensure that there is no breach of the peace. The secured creditor then has the option to dispose of the collateral either through public or private sales or through judicial sales. The extra costs of applying for a court order for judicial seizure of the collateral must be paid by the debtor.

After obtaining possession of the collateral, the secured party has the right to sell or otherwise dispose of the collateral and apply its value to satisfy the secured debt. Modern secured transactions laws afford the secured creditor a number of foreclosure options.

Non-judicial private or public sale: A secured creditor may lease, sell, license, or otherwise dispose the collateral at a public or private sale and apply proceeds first to the costs of the enforcement and then to the balance of the loan. However, the manner in which such sales are conducted must be "commercially reasonable".

Strict foreclosure: In lieu of collateral disposition, a secured creditor may take the collateral in full or partial satisfaction of the debt obligation after default (often referred to as "strict foreclosure").

Judicial foreclosure: Judicial foreclosures, which involve court orders that directly dispose of collateral, always remain an enforcement option for the secured creditor. Judicial foreclosures, however, can be slow and costly. Experience in many countries demonstrates that court enforcement is a significant obstacle to the use of secured financing arrangements. Too often, courts are so overworked that applications for enforcement are delayed for very long periods of time. Meanwhile, the collateral either deteriorates or is destroyed or disposed of by debtors. Court proceedings involve significant costs that are paid either by the defaulting debtor or (most often) by the secured creditor. Court officials are the only persons with authority to seize and sell collateral, but they are often overworked or have little incentive to act expeditiously so as to avoid loss or depreciation of collateral. Furthermore, they lack the expertise or facilities to ensure that the full market price of the collateral they sell is realized.

In recent years, many countries have simplified the judicial process for enforcing secured debt. When judicial seizure is involved, the courts have used summary legal proceedings to limit judicial findings to the existence of agreement granting the security interest and an event of default. Albania, Bulgaria and Romania have experienced positive results by recently introducing expedited court proceedings to repossess movables upon default.

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