Executive Summary

Purposes and Provisions of the Proposed

Act on the Use of Movable Property to Secure Obligations

Purpose. The purpose of the proposed Act is to promote commerce. The Act assumes that greater access to business credit will lead to more economic activity, more jobs, a stronger economy, and higher living standards. The Act, therefore, seeks to strengthen the law on the use of movable property to secure obligations.

Why focus on movable property? Sources of business credit are limited to personal guarantee, credit secured by mortgage, and credit secured by movable property. Personal guarantee is insufficient to meet the needs of any business except the smallest. Credit secured by mortgage is limited because there is so little land and so few landowners. The remaining source of security – movable property – is the chief source of business credit in developed economies. Many developing countries have updated their laws on movable property financing. Movable property financing permits entrepreneurs with good character and business plans to obtain business capital without owning land. Movable property financing is democratizing because it allows many more people to participate in productive economic activity. The proposed Act adapts the successful experience of developed and developing countries to the unique circumstances of Bangladesh.

Benefits for business. The proposed Act addresses the need for credit in a variety of commercial contexts in which movable property is crucial:

- Equipment financing – revitalizes existing industry, creates opportunity for new industry, and increases productivity.
- Inventory financing – improves opportunities for wholesaling and retailing, allows businesses to start up with no land and with little startup capital.
- Receivables financing – permits credit based on the book debt (accounts) of a company, providing working capital that is essential to success in business.
- Building improvements financing – improves credit for new generators, wells, pumps, lifts, air conditioners, and the like. This increases the value of land and buildings, and creates jobs in sales, installation, and maintenance.
- Crops and livestock financing – increases agricultural efficiency and output by providing cash-flow that is sensitive to growing seasons and other special situations confronted by farmers.
- Consumer goods financing – increases access to credit for purchase of appliance and furnishings, increasing living standards and creating jobs in sales, delivery, and maintenance.

Benefits for creditors. The proposed Act creates a more positive climate for business credit in several ways. First, the Act creates a single, consistent, and codified set of rules for creating security in movable property. Second, the Act establishes clear rules by which competing claims to movable property are to be resolved. Third, the Act creates a simple and inexpensive public records system to provide information on all claims to movable property against all debtors. Fourth, upon default by the debtor, the Act improves the creditor's ability to enforce claims against movable property that secures the debt. At all times, the Act minimizes the costs of creating and enforcing security in movable property. The following discussion provides more detail on these four points, and how the proposed Act adapts the successful experience of other countries to the circumstances of Bangladesh.

1. Rules for creating security (sections 1-11). Bangladesh creditors use several forms to secure obligations with movable property. Examples are pledge, hire/purchase, assignment, hypothecation, and financial leasing. Depending on the form, the law creates different rights, obligations, and consequences, even though the commercial effect – to create security in movable property – is the same. Compliance with legal formalities is expensive. Lawyers are involved in nearly all transactions. Some transactions are subject to stamp duty while others are not. The law does not adequately address creditor the right to proceeds from the disposition of the secured movable property, such as accounts (book debt), cash received on account, or goods purchased with the cash.

The proposed Act creates a new property right – a charge – that may attach to any movable property for the purpose of securing an obligation. The movables may be tangible, such as goods, or intangible, such as accounts. The movables may exist at the creation of the charge, or may arise in the future. Any person or entity may give a charge or take a charge. The charge is created by agreement of the parties, without official approval. The charge automatically attaches to proceeds of charged property, upon the sale or exchange of the property. In creating a charge, the rights and obligations of the creditor and debtor are the same, no matter what the form of the transaction and no matter what the form of the movable property.

2. Priority among competing claims (sections 12-26). Many people might claim rights in the same movable property. The Act clearly defines the rights of competing creditors to the same property. Who might these people be? Suppose the debtor sells charged property. Suppose the debtor pledges property after the creditor takes a charge in it. Suppose the debtor pledges property while it is subject to a financial lease. Suppose charged property becomes subject to a tax lien, to an execution order, or to the power of a bankruptcy receiver. Without strong law, it is risky to take movable property as security.

Creditors must know the answer to every possible contest in advance. There is a price otherwise. The price is less credit, with more collateral, at higher interest rates. The creditor will not pay the price. The price is be paid by the majority who pay their debts on time and in full.

The proposed Act defines the rights of competing creditors clearly, so the creditor can judge credit risk today, without guessing about unknown events tomorrow. In general, the first to file in the filing office, or registry, has the first claim to the movable property. There are limited exceptions where necessary to promote commerce. But the Act informs the creditor, in advance, of all possible outcomes so all possibilities can be taken into account in making loan decisions.

3. Public information about existing claims (sections 27-38). Suppose a debtor offers his manufacturing equipment as security for a loan. The creditors must know whether a prior creditor has a claim to the property. The information must be obtained quickly, it must be accurate, and the price must be low. Otherwise, the debtor's loan will be delayed, the amount will be lower, and the cost will be higher. There is no room for uncertainty.

In Bangladesh today, the Registry of Joint Stock Companies (RJSC) tries to provide such information. But if some of the debtor's equipment has been purchased under a financial lease, a search of RJSC records will not reveal the leases because financial leases are not subject to registration at the RJSC. If the debtor is not a joint stock company, there will be no information whatsoever, even if all of the debtor's equipment is encumbered, because the Joint Stock Company registry covers only the encumbrances on the property of joint stock companies.

The RJSC covers <u>some</u> of movable property of <u>some</u> of debtors. Modern commerce needs public information about <u>all</u> movable property of <u>all</u> debtors.

The proposed Act creates a public information system containing information about claims on <u>all</u> movable property for <u>all</u> debtors. The system may be entirely electronic, so the creditor can have information available at the desktop. The system is designed as an <u>**e-commerce**</u> solution to an important business problem. Searching the system is to be instant and inexpensive, if not free. Transaction costs should be low. Professional services should not be required to perform searches.

Under the Act, operators of the system have no authority to examine, verify, approve, delay, or tax information that enters the system.

4. Enforcement rights (sections 39-46). The proposed Act strengthens the creditor's enforcement rights with respect to movable property. First, no matter what the form of transaction, the creditor has the right to possession of the charged property upon default. If the debtor refuses to give up the charged property, the creditor has a right to a court order granting the creditor possession of the property. The Act creates expedited procedures for obtaining such an order, if necessary.

Second, the Act authorizes the creditor to dispose of the movable property by public or private sale. There is no need to rely upon judicial sale, no matter what the form of transaction and no matter what the type of charged property. The purpose of these provisions is to recognize that the creditor, not the court, has the best incentive to obtain the best possible price for the charged property, in order to satisfy the highest possible portion of the secured debt.

Summary. The proposed Act adapts the successful experience of other countries to the circumstances of Bangladesh. The proposed Act (1) unifies legal formalities with respect to credit for movables, (2) resolves disputes over charged property in advance, (3) establishes an electronic and universal public information system, and (4) strengthens enforcement rights. By doing so, more business credit will be available. Debtors will be required to give less charged property. Interest rates should be reduced. These results can be expected because creditor security is maximized, freeing the creditor to make informed credit decisions at low cost.

Under current practice, the cost of uncertainty and delay is paid, not by defaulters, but by every business and every borrower. The cost is paid in the form of less credit at higher interest rates, under greater demand for security. If the policies of the proposed Act are implemented, good borrowers no longer have to pay the costs imposed by defaulting debtors. Borrowers will get real value when they offer collateral, and lenders will get real security.