

MEMORANDUM

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TO: Mr. Kyoichi Kato, MIF/DEP

THROUGH: Miguel Rivera, RE3/DEP

FROM: Frank Vukmanic, OD6/CHF

SUBJECT: Trinidad and Tobago. Proposal for a Technical Cooperation to Support Improvements in the Secured Transaction System (TC9908028).

The following is a description of a proposed Technical Cooperation for which RE3/OD6 seeks an expression of MIF project eligibility:

BACKGROUND AND OBJECTIVES: The objective of the proposed non-reimbursable Technical Cooperation is to improve, in a sustainable manner, the conditions for access to credit services for enterprises of all sizes, but specifically small and medium size businesses. This is to be achieved by improving the legal and institutional framework of the bankable property rights system.

A healthy, growing economy relies on financial institutions to act as intermediaries between savers and borrowers. However, for financial intermediaries to adequately fulfill their role and provide financing while protecting their depositors' funds, they require an efficient, reliable system of laws and institutions. In particular, ease in the establishment and enforcement of security interests, as well as the availability and use of information constitute vital elements for the system's efficient functioning, and its ability to adequately assess payment and "default risks" in lending operations. Where the legal and institutional system for establishing and registering security interest is cumbersome, ambivalent and expensive, credit allocation will be sub-optimal. Loan products will tend to favor short term lending, traditional clients, and larger loans to wealthier customers, severely curtailing access for new and smaller businesses. Smaller businesses' access to credit is further constrained when reliable, independent information on the clients' current debt and credit history is not available to the potential lender. To facilitate smaller borrowers' access to the formal sector credit, lenders must be able to: (i) ascertain a borrower's capacity to service a debt; (ii) ascertain its priority in security interests vis-à-vis other creditors with a reasonable effort; (iii) easily register its interest in a debtor's movable collateral; and (iv) easily enforce default remedies.

Regulatory and Legal Framework. Trinidad & Tobago's institutional and legal framework for secured transactions presents a number of deficiencies, which impede an optimal allocation of credit resources. While there are various legal provisions for the creation,

registration and enforcement of different types of security interests, the law of secured transactions has evolved in an incremental, fragmented manner, a trend currently continuing with the recent introduction in Parliament of the Registration of Charges Act. With this latest Act Trinidad & Tobago has at least five different statutes that deal directly with secured financing transactions. As a result, the current structure is highly complex, formalistic and lacks harmony, creating obstacles for the unwary, enormous potential for error and elevated transaction costs. Users of the system must be highly specialized, since the use of security devices varies extensively with different types of creditors, lenders and property involved, creating “exclusivity” for the use of certain instruments by determined creditors. This is the case of the charge created pursuant to the *Co-operative Financial Institutions Act*, which is only available to credit unions, whereas charges under the *Bills of Sale Act* apply only to lenders on the security of chattels; and *corporate debentures* only to incorporated businesses. Uncertainty as to priorities of creditors (as a consequence of the existence of unregistered overriding interests, such as *hire purchases* and *credit sales agreements*), and obscure statutory provisions for publication further increase the costs of establishing security interests.

Registry Systems. The distortions caused by the legal and regulatory framework are compounded by deficiencies in the record keeping and publication system for security interests. While the system is improving and computerization will further enhance performance, it remains fragmented, forcing potential creditors to search through different registration systems in order to ascertain priorities. The proposed Registration of Charges Act will further fragment the registration system by stipulating that the registry of charges under this Act will be created and operated by the Motor Vehicle Licensing Authority, an agency with no prior experience in that task and no relationship to other registry systems. Given that creditors’ confidence in the reliability, accuracy and timeliness of the information system is an important component in the evaluation of the default risk of loans and the financing decisions, the system’s current fragmentation creates disincentives for expanded lending, especially to smaller enterprises.

Debtor Information Systems. Trinidad & Tobago’s debtor information systems further hinder efficient credit allocation. Even if creditors are able to assess their priorities, their ability to assess a debtor’s “payment risks”, is limited, largely due to imperfect information about the nature and extent of a borrower’s total debt and credit history. Independent information of this nature is typically provided by *Credit Bureaus*. There are a several local credit bureaus operating in Trinidad & Tobago, mostly as collateral business to other activities, such as debt collection services. However, their scale of operation and sophistication is limited and the information gathered and provided tends to be incomplete and outdated, putting debtors and creditors at a disadvantageous position. Adequate protection of debtors’ and creditors’ interests, confidentiality of information and the regulatory framework for operations remain issues to be resolved, in order expand the availability of debtor information and contribute to expansion of lending activities.

ACTIVITIES AND EXPECTED RESULTS: The proposed operation would help to reduce the deficiencies in the current legal and institutional framework for secured transactions, and the debtor information system. This would enhance creditors’ ability to better assess “default risks” and “payment risks” of borrowers, thereby contributing to an expansion of banks’ lending base, particularly toward including smaller enterprises and new debtors. The operation would address four areas of activities:

Legal Reform. The project would provide assistance to the authorities and other stakeholders to consolidate and modernize the legal framework for secured transactions in movable property, principally through a review of existing legislation and the drafting of a new law – the *Moveable Property Security Act* (MPSA) -, which would replace the existing statutes governing this field. While building upon existing local law in a manner that integrates, clarifies and modernizes the current regulatory structure, the MPSA would be modeled on Article 9 of the Uniform Commercial Code of the U.S or a comparable Personal Property Security Act from one of Canada's provinces. The legislation would not abolish previous security devices, but instead provide a uniform set of rules governing them, especially regarding creation, registration, priorities and remedies upon default.

Registry Systems. Parallel to the introduction of new legislation for secured transactions, the project would provide assistance to Government to modify the proposed computerized registry system to accommodate the new form of charge created by the proposed MPSA. The project would assist in establishing a single computerized registry, the *Moveable Property Registry* (MPR), where notice of all secured transactions would be registered. The MPR would facilitate both registration of financing agreements and recovery of information and would provide remote registration and search facilities. Recorded information against a particular debtor or against a serial numbered item would be available through a single registry search, providing comprehensive information on all existing security agreements affecting that registry.

Debtor Information Systems/Credit Bureau. The operation would provide assistance to the Government, commercial banks and other interested parties to establish the legal and technical framework for an efficient credit bureau system. Activities would focus on assistance in drafting legislation and regulation for the licensing and operation of credit bureaus, which would include measures to ensure accuracy and fairness in the contents of credit report and the confidentiality of the information, as well as stipulations regarding the rights and responsibilities of creditors and debtors. The operation would also provide technical support for the development of a fully operational and reliable credit bureau.

Continuing Legal Education and Dissemination. Few judges and lawyers in Trinidad & Tobago have a profound understanding and practice of commercial law cases or, more broadly, cases dealing with business, such as secured transactions litigation. Moreover, frequently judges are appointed to the Bench because of their knowledge of criminal law. The proposed changes in the secured transaction legislation, in order to be efficiently implemented and applied, need to be introduced to the legal community through a process of stakeholder consultation and training. This would include seminars and workshops dealing with the legislation, specific case analysis and comparative analysis of other legal systems, in order to establish legal precedents. In addition, recent and impending changes in commercial legislation, which interlocks with the proposed reforms, and the general lack of specialization within the legal community in commercial legislation make it paramount to provide assistance in establishing continuing legal education in this area for the legal community and other stakeholders, so as to contribute to the efficient functioning of the whole system. . Furthermore, general public awareness of and confidence in the legal changes would be raised through dissemination efforts.

The operation would finance mainly specialized international and national consultant services in all the above outlined areas. It is expected that limited funding would also be provided for the acquisition or upgrading of the necessary software and hardware for the registry and debtor information systems, as well as specific training of staff.

PROJECT EXECUTION: The Executing Agency would be the Trinidad and Tobago Chamber of Commerce (the Chamber). The Chamber would act as the secretariat of the project and assume responsibility for the coordination of tasks, hiring of external consultants and purchasing of equipment, administration of project funds, as well as reporting to the Bank. In addition, the Chamber would coordinate the establishment and activities of an advisory task force, comprised of *Stakeholders* from the private and public sector, as well as the legal and academic community, to review and advise on project activities.

For project implementation the Chamber would enter into subsidiary execution agreements with public sector entities, such as the Office of the Attorney General and the Ministry of Legal Affairs, for the execution of component one and two, and the Bankers Association for the execution of component three. The Chamber would coordinate the implementation of the fourth component.

The Chamber is the most suitable execution agency, given its reputation in the private and public sector, and its capacity to serve as an effective “bridge” between those sectors, as well as between diverse constituent groups in both sectors. Government officials expressed their comfort with the proposed execution arrangement and the role of the Chamber, indicating positive prior experience in working with the Chamber in the reform of the *Companies Act* and with drafting legislation on intellectual property. Members of the legal community and the Bankers Association also endorsed the proposed arrangement. The Chamber has an appropriate infrastructure and staffing level to perform the proposed activities. For contracting of external consultants and acquisition of equipment the Chamber is not subject to public sector processing rules, which would allow for added expediency in project implementation.

It is expected that project execution would focus initially strongly on the legal reform component, with limited work being carried out in the other components, given that the successful implementation of the proposed legal changes impacts on the execution of the other components. Upon implementation of the legal reform, project activities would focus on the other three components.

The project execution period is expected to not exceed 24 months, with a disbursement period of 30 months.**BENEFICIARIES:** The operation’s immediate beneficiaries would be all debtors (individuals and businesses) and creditors establishing security interests, which would benefit from a strengthened legal and institutional framework. In the medium term the proposed operation would enhance private sector development, through the facilitation of broader access to credit services, especially by smaller and newer enterprises.

JUSTIFICATION AND RISK: Credit allocation in Trinidad & Tobago is only sub-optimal due to lenders’ constraints in evaluating efficiently “payment risks” and “default risks” of potential borrowers. The strengthening of the legal, regulatory and institutional framework for secured transactions would make the process of secured financing more efficient and would reduce “payment risks” for lenders. In particular, the changes proposed by the operation would provide a simple and efficient means for lenders to establish and verify security interests in specific, limited items of collateral, or floating liens over borrowers’ assets, as well as allow expeditious remedies on default, thereby facilitating the expansion of credit services. The proposed reforms would bring Trinidad & Tobago’s legislation on secured transactions in line with the legislation of the commercially most important jurisdictions in North America and provide the country with the most modern law on the subject in the Caribbean. Furthermore, strengthening the debtor information systems, while improving rules for confidentiality of information and protection of debtors’

and creditors' interest, would contribute to reduce "default risks" for lenders, further increasing their incentives to expand the lending base.

Successful implementation of the operation and reforms will require extensive inter-institutional coordination and the participation of various stakeholder groups in the process, in order to reduce the operation's risks. In particular, the successful passing of the proposed legislative changes in Parliament will require consensus-building efforts. Coordination, dissemination and outreach efforts of the project would help to mitigate those risks.

PRELIMINARY FINANCING PLAN: Project costs are estimated at US\$850,000, with US\$510,000 to be contributed by the MIF and US\$340,000 as local counterpart funding, equivalent to 40% of total estimated costs. Counterpart funding will be provided by the Chamber of Commerce, as well as the public sector and the Bankers Association.

MIF: US\$510,000

Local Counterpart: US\$340,000 (40%)

Total: US\$850,000

RELATIONS WITH OTHER BANK PROJECTS: The proposed operation is consistent with the Bank's country strategy aimed at supporting the diversification and competitiveness of Trinidad & Tobago's economy, and the strengthening of the role of the private sector, in as much as it will improve the legal and institutional framework for sector's financial operations. Furthermore, the operation would complement Bank efforts to improve efficiencies in the financial sector, and would foster Government and Bank efforts to enhance small and medium enterprises' access to financial services.

NEXT STEPS: OD6/RE3 will anticipate a response from the MIF as to whether this project is eligible for MIF funding. If eligibility is granted, the understanding of OD6 is that we can proceed directly with the preparation of a draft Donor's Memorandum for the operation.

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