Secured Transactions Reform and Access to Credit BY FREDERIQUE DAHAN and JOHN SIMPSON, eds. [Cheltenham: Edward Elgar, 2008. x + 283 pp. Hardback: £ 69.95]

It is probably universally accepted that the ability of financial institutions to take collateral is a prime factor which determines whether businesses have access to finance. Few bankers would lend without some form of security to maximise the certainty that their loans will be repaid. The empirical studies in this book highlight that access to finance is an important engine that drives economic growth and powers the transition from a centrally planned economy to a market economy. The general conclusion of the book is that legal reform is necessary to allow financial institutions to effectively take collateral, and that institutional frameworks must be developed to facilitate wider access to credit. Those of us, especially lawyers, operating in developed market economies with easy access to credit might take for granted the legal and institutional frameworks which make this possible, to the extent that we spare little time to make the link between the law of secured credit and the economic effect of these laws. Indeed, the book may not be directly relevant to such persons. Being based on an international workshop held at the headquarters of the Economic Bank for Reconstruction and Development (EBRD) in London in 2006, the book is naturally written from a developmental law perspective. However, with its insightful analysis, interesting empirical studies and knowledgeable team of contributors, the book will be illuminating and useful not just for those interested in development, but also anyone who has anything to do with granting credit and taking security. The book takes an interdisciplinary approach, which should help lawyers ensure, on the one hand, that 'legal solutions are designed to address economic needs', and economists to ensure, on the other, that "economic analysis takes into account the complexity and subtlety of legal and institutional systems" (at page x).

Part 1 of the book consists of two chapters that examine the legal and institutional pre-conditions for unlocking access to credit, as well as the policy choices that would encourage an efficient and inclusive financial system. Chapter 1 refers to empirical studies that show that the establishment of information sharing institutions such as credit bureaus, stronger creditor rights and simpler civil procedure rules have a large economic impact on credit access. It concludes that reforms should aim at improving the inter-related institutional areas that foster credit access. This view is well supported by Chapter 2, which points out an empirical link between access to financial services (particularly credit) and business growth. Chapter 2 introduces an interesting dichotomy between a deep and efficient financial system as compared to a broad and inclusive one. The former looks at matters such as the ratio of private credit to GDP, whilst the latter considers the degree of penetration of financial services and examines questions such as the percentage of the population that take up loans. It would appear that both depth and breadth are important for economic development and poverty alleviation. Other important policy areas that foster financial sector development include macro-economic stability (*e.g.*, low and stable inflation rates); effective and reliable informational frameworks (*e.g.*, transparent and comprehensive accounting standards); effective and reliable contractual frameworks (*e.g.*, certainty of legal rights, and assurance of fair and speedy enforcement); and the willingness of governments to play a role in developing institutional infrastructure and in setting appropriate policies for supervision and for promoting competition. Whilst the credibility of the assertions and conclusions in Chapters 1 and 2 would ultimately depend on an assessment of the rigour of the empirical investigation, these findings are intuitively logical and sensible, and there seems little cause to view them with undue suspicion.

On the basis of the thesis of the book as discussed in the first two paragraphs of this review, it is clear that any country that does not have a conducive legal and institutional framework for credit access should look into reforming its system. This is particularly true as the investment needs of developing countries will largely have to be funded by private financial sector lenders, for which collateral would be important. Without collateral, there will be issues of adverse selection (where lenders may raise interest rates to bring supply in line with demand, in the process of which many honest borrowers may drop out), moral hazard (where lenders may limit loan size because borrowers who have re-paid a loan previously may not necessarily honour a new, larger one since the benefits of default might be greater) and uninsurable risk (such as disabling illness of the borrower or a mistaken business decision). In contrast, the availability of collateral will generally lead to lower overall interest rates, larger amounts of individual loans, and longer time periods for repayment.

The process of reform may face certain general problems, as discussed in Part 2. Chapter 3 observes that although the benefits of reform would appear to outweigh its costs, governments, donors and other stakeholders appear not to be overly enthusiastic about the process. However, all is not lost and the prognosis is cautiously optimistic, as the number of legal reform projects are increasing, and donors appear to be willing to finance even duplicative efforts when unsuccessful measures have to be redone. An important aspect of the reform process is to adopt rules that will allow borrowers to use the assets which they have as collateral. For instance, the assets of many small and medium sized businesses consist mainly of movable property, which in many unreformed systems, cannot be used to secure loans. Reform should therefore be designed to help businesses turn such dead capital into productive capital which can be used as security. As Chapter 4 shows, this has been facilitated in Romania and Albania by the setting up of registries that allow pledges over movable property to be registered. However, bringing about reform is not an end in itself. In order for reformed systems to be fine-tuned to ensure optimal operation, it is useful at the outset to define the objectives of the reform and eventually to assess the success of the reform against these objectives. Some ways of measuring success might be to use the legal efficiency criteria suggested in Chapter 5, such as achievement of legal function, simplicity, speed, cost and certainty.

Part 3 discusses how security is taken in practice in various lending environments. It is fascinating that even lenders who do business in a difficult, unreformed environment such as Azerbaijan (Chapter 6) are able to effectively enforce their loans by creative and psychological measures. One example is the confiscation of the borrower's property upon default so that the inconvenience caused provides an incentive for payment. Another is the tight monitoring of defaults, whereby the borrower would be contacted by a loans officer the very day that payment is due, so that he and other borrowers who default out of negligence quickly learn the standards of compliance expected of them. Chapter 7 suggests that the availability of secured credit may not be relevant to all types of lending, and in particular, that it is not an important factor for the microfinance industry. This is understandable, given the special characteristics of microfinance, where small loans are provided to low-income individuals, often in rural settings. The taking of security is problematic for practical reasons, particularly in the context of developing countries, and lenders typically use alternative mechanisms (such as a careful analysis of cash flows as a determinant of the borrower's ability to repay) in order to reduce the likelihood of borrower default. In contrast, the rise of home ownership rates in the transition economies of Central and Eastern Europe and Central Asia has led to the accumulation of a huge capital stock which can be used as collateral to finance business activities, and this has led to a corresponding development of land registration systems which have opened up new possibilities for mortgage financing in these countries (Chapter 8).

Useful lessons can be drawn from the stories of reform contained in Part 4. Whilst successful and wide ranging reform of secured transactions has been implemented in the transition economies of Slovakia (Chapter 9) and Romania (Chapter 10), the process of reform has proved more challenging and difficult in Latin America (Chapter 11). Chapter 12 discusses the reform of the French Civil Code in 2006 to include Book IV which is dedicated to the reform of security rights and guarantees. Although France is not a country that falls within the purview of the EBRD, the French experience is relevant to the countries in which EBRD operates, as the legal traditions of these countries generally have civil law origins. The thinking might be that if France could achieve success, this would show that a renaissance of the secured transactions regime is feasible for civil law countries, despite their being thought sometimes to be slow to adapt to modern financial markets. Unfortunately, the assessment in Chapter 12 is that the French reform has failed to live up to its potential.

The book does not address the common law position regarding secured transactions. Some common law countries such as the U.S. and New Zealand have well developed laws for the taking of security over both immovable and personal property. Others, such as the U.K. and Singapore, have laws which are generally acknowledged to be less than perfect. There has been discussion in the U.K. and, to a more limited extent, in Singapore, of the desirability to reform the law relating to secured transactions and personal property security so as to make existing rules more coherent, but no action has been taken so far. Granted, the situation is less urgent in Singapore and the U.K. than in the transition economies covered in the book. In both countries, there is a well developed (though not necessarily coherent or comprehensive) legal framework for taking security under the common law, and also under statutes such as the bills of sale legislation (for chattels belonging to individuals) and the companies legislation (for the registration of company charges, including floating charges). However, the central message of the book, supported by empirical studies, is significant for lawmakers: An efficient system of taking and enforcing collateral is an important pre-requisite that affects the availability and cost of credit, and this in turn affects the level of economic development in a country. It is possible that legal reform may have less positive effect in a country that already has developed laws and institutions governing secured transactions as compared to a country, like the transition economies considered in the book, where such a framework is lacking. Nevertheless, the link between law and economics—consistently highlighted in various chapters of the book—suggests that such reform is likely to be economically beneficial also in a country where the laws relating to secured credit can be further improved.

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