A Guide to a Successful Adoption and Implementation of the Organization of American States Model Law on Secured Transactions and Registry Regulations in Honduras — The National Law Center Experience

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N. Final Remarks

A. Introduction

Access to credit has been identified as one of the critical stimulants of economic development. Companies, particularly small and medium-sized need credit to grow and to increase employment. Access to credit also has a vital social dimension in facilitating acquisition of consumer goods by individuals and, thus, increasing their quality of life and the quality of the lives of those who sell these goods as manufacturers, wholesalers and retailers. The overall economic impact of an efficient secured transactions system is significant. Yet, many countries, including those in Latin America lack a modern secured transactions system that would stimulate economic growth. Statistics indicate that presently, 45 years after the study that Prof. Boris Kozolchyk conducted on the credit structure in Latin America, 45.8% of all businesses in Latin America don’t have access to any credit. How can these businesses remain operational, increase their production and contribute to economic growth of the country? How can Latin American countries become competitive in the global marketplace? The solution lies in modernizing the secured transactions legal framework as was proposed in the Law and the Credit Structure in Latin America and subsequently in Toward a Theory on Law in Economic Development: The Costa Rican USAID — ROCAP Law Reform Project in 1971.


A number of international and regional organizations recently drafted international conventions, model laws, legislative guides, and toolkits to promote modernization of secured transactions laws. Countries wishing to modernize their legal framework have a number of sources available to guide them through the law-making process. The OAS Inter-American Law on Secured Transactions (hereinafter OAS Model Law), adopted in 2002, was designed for Latin American countries to modernize their secured transactions laws and bring them closer to the legislation of the United States under the Uniform Commercial Code Article 9 (hereinafter UCC 9) and the Canadian Personal Property Security Act (hereinafter PPSA). In 2009, the OAS adopted the Model Registry Regulations under the Model Inter-American Law on Secured Transactions (hereinafter the OAS Registry Regulations). However, the OAS Model Law does not merely copy the fundamental concepts of UCC 9 and PPSA such as the perfection of a security interest by registration, but is rooted in the traditional concepts of Roman law such as the possessory rights in property owned by third parties (iura in re aliena) and the first-in-time, first-in-right priority rule. The combination of modern and traditional concepts set the OAS Model Law on the path for widespread implementation throughout Latin America. However, the results have been

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5See the OAS Model Inter-American Law on Secured Transactions adopted on February 8, 2002 by the Sixth Inter-American Specialized Conference on Private International Law (known as “CIDIP-VI”, for its Spanish acronym) (March 5, 2002), the Model Registry Regulations under the Model Inter-American Law on Secured Transactions approved by Seventh Inter-American Specialized Conference on Private International Law (CIDIP-VII) (October 9, 2009) and the European Bank for Reconstruction and Development, Model Law on Secured Transactions (1994).


7IFC, supra note 2.

8On the history of extra-judicial remedies and their roots in Roman law see Kozolchyk & Wilson, supra note 1, at 88.
mixed thus far.9 Almost a decade after promulgation of the OAS Model Law, Honduras became the first country in Latin America to successfully implement it. Other countries in the region including Guatemala, Mexico and Peru have implemented the OAS Model Law and OAS Registry Regulations albeit only partially.

Successful implementation of an efficient secured lending legal framework requires much more than mere transcription of a model law or following recommendations set forth in a guide on the drafting of a secured transactions law. This article identifies the fundamental components of secured transactions legal reform projects as developed in approximately two decades of work by the National Law Center for Inter-American Free Trade (hereinafter NLCIFT). Although it describes implementation of the OAS Model Law and the OAS Registry Regulations in Honduras, the processes and steps identified below are largely applicable to secured transactions reform projects in Africa, Asia and Europe. Honduras’ recently enacted secured transactions law (hereinafter Honduran STL) entered into force on August 28, 2010, the registry regulations (hereinafter Honduran RR) were signed on December 21, 2010 and the registry became operational on January 28, 2011.10 The Honduran reform project implemented by the NLCIFT was funded by the Millennium Challenge Corporation (MCC). An announcement posted on the MCC’s website, entitled “Results on the Ground,” says the following about the Honduran reform project: “In the case of secured transactions reform in Honduras, a relatively small investment is having a significant ripple effect: reforming the Honduran credit sector, increasing opportunities, and serving as a model for economic policy reform in the region.”11 The main objective of this article is to show why the mere adoption of a modern secured transactions law will not alone produce the desired

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9. Garro, supra note 1, at 394.
economic results, including increased access to credit and economic development.

B. Step 1: Identify Applicable Laws

It is difficult to find a legal system that does not provide mechanisms that allow creditors to loan money and take a security interest in the borrower’s assets. In many systems, these mechanisms are limited to possessory pledges and retention/transfers of ownership. Under the former, the creditor takes physical possession of the collateral effectively preventing its economic use. Under the latter, the creditor such as a seller or financial lessor retains ownership of the collateral without providing notice to third parties. As a result, the debtor may be in possession of some assets but have no ownership or the right to transfer with respect to those assets. These devices typically need not be made public by registration to become effective against third parties. For example, Article 779 of the Honduran Commercial Code, enacted in 1952 and still in force, requires registration of retention-of-title devices but only with respect to the enumerated assets such as immovables, vehicles, and some equipment, etc. If a supplier of, say, t-shirts retained ownership, third parties dealing with the retailer of those t-shirts would not know that the inventory is owned by the supplier. Lenders may thus advance funds against collateral in which the debtor has no rights and lose to the seller who claims ownership. Latin American countries include these and similar devices in their Civil and Commercial Codes. In addition, countries also frequently adopt statutes providing for security mechanisms on an ad hoc or case-by-case basis such as for the pledge of agricultural assets.

As part of the indispensable purely “normative” or pre-existing positive law analysis, these mechanisms and the applicable legal rules must be identified and either adjusted so that they can become a coherent part of the new secured transactions law or be entirely abrogated. Among those pre

12See CÓDIGO DE COMERCIO, art. 495 that provides for the pledge of a negotiable instrument. For such a pledge to be effected, the holder must endorse the instrument with “in guarantee,” “as pledge” or similar language. Article 2056 provides for the right to secure an obligation with a pledge of any movable asset.

13See LEY DE PREnda AGRARIA O INDUSTRIAL (Nicar.) and LEY DE PREnda AGRARIA (Arg.). See further Kozolchyk & Wilson, supra note 1, at 35.
existing mechanisms that can be adjusted to the conceptual structure of the new law are retentions of title, financial leases, outright or fiduciary transfers of ownership which in essence confer possessory rights to the secured lender and thus can function as security interests by securing the repayment of a debt or satisfaction of an obligation. The Honduran STL follows the functional approach of the OAS Model Law because it applies to all security mechanisms irrespective of their formal label or the fact that the “ultimate” or “historical” owner of the collateral could be the debtor, the secured creditor or a third party. Consequently, conflicts among creditors are not resolved on the basis of the type of property right (e.g., ownership, security interest, right to possession, etc.) that creditors assert but on the transparent basis of who publicized their “preferential possessory” rights in the collateral first. The objective is to enact a single statute that would govern the creation or attachment, perfection or public notice and priority of all security interests.

C. Step 2: Do a Roadmap/Diagnostic of Practices

A critical component and the starting point of every secured transactions reform undertaken by NLCIFT is a study that maps out the existing financing practices, identifies the typical lenders, borrowers and collateral found in the local market. In addition, the study must identify the existing types of registries, their nature — whether document-registration or notice-filing, the formalities necessary to effect a registration as well as the legal effects of registration — whether “constitutive” or as a creator of rights in rem between the secured creditors and third parties or just as a provider of public notice of potentially existing security interest of the secured creditor. Equally relevant are other socio-economic aspects such as the attitude of people towards credit and the government policy in terms of promoting access to credit. For example, do the potential lenders trust the financial statements or accounts receivable provided by the borrowers as collateral? Or does the business and legal culture only foster trust in formal or notarial paper-based

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14 See OAS Model Law, supra note 5, art. 2 and Honduran STL, supra note 10, art. 2.
15 See OAS Model Law, supra note 5, art. 48 and Honduran STL, supra note 10, art. 50.
16 See further Kozolchyk, supra note 1, at 29.
documents as contrasted with electronic records? All of this information is necessary to draft an adequate but most of all local culture reflective secured transactions law and registry regulations.

The roadmap should not be limited to the relevant financial, legal and socio-economic information. It should also include an overview of the existing business practices. The most sound of these practices will then be isolated and form the basis for future sets of best business practices. Understanding of the borrowers’ side of a secured transaction is equally important as knowing how lenders finance and what collateral they prefer. For instance, the roadmap must answer simple but important questions like: “How can a Honduran grower and exporter of coffee benefit from a modern secured transactions law?” Typically, coffee producers own very little or no equipment and the production is very labor-intensive. It may take up to four years for a coffee tree to start producing beans. Coffee is also regularly warehoused but its quality deteriorates after two years of storage. A coffee producer would have difficulties accessing credit at a reasonable rate if the secured transactions law did not allow a security interest to attach to after-acquired property. If this were not the case, every time a coffee tree bore beans a new security agreement would have to be executed and a new registration made. This practice would significantly drive up the cost of credit.

Agriculture is a sector that is highly labor-intensive. Many Honduran family farmers don’t own any means of transportation and are not able to deliver their produce to the market. Consequently, they typically sell their fruits and vegetables to an intermediary called the coyote for a significant discount. The coyote then transports the produce to a market where he re-sells it and makes a significant profit due to the inability of the farmer to obtain purchase money financing for a truck. The secured transactions law must allow lenders to provide purchase money loans to acquire vehicles and other equipment, and grant them priority even over pre-existing security interests in the same category of

17 See infra Part I.
18 NLCIFT, Roadmap, Deliverable #3 of the Contract for Consulting Services between the Millennium Challenge Account (MCA) — Honduras and the National Law Center for Inter-American Free Trade 3–5 (December 2007) (on file with author).
These two examples demonstrate how critical it is to understand the transaction and the manner in which parties conduct business in the particular environment.

Many Honduran businesses are located in public markets that are housed in large steel structures that contain hundreds of small stalls selling shoes, cheese, meat, etc. The most common type of collateral that these businesses utilize to access credit is a license to operate the stall in the relevant public market. There might be up to 100,000 of these stall owners in Honduras. Since space in the public market is limited, so is the number of licenses. Licenses to operate stalls are desirable collateral due to their liquidity, i.e., existence of the secondary re-sale market. The market prices of goods sold by stalls in the public market are generally higher than those sold in the streets. Given the high value of these licenses and the viable secondary market, the Honduran RR recognize them as one type of serial-numbered asset. Certain serial-numbered assets such as vehicles, high-value equipment and licenses must be described in the registration form by a serial number assigned by the manufacturer or issuing authority for the security interest to take effect against third parties.

In addition to accessing credit by way of providing their licenses as collateral, many stall owners have access to the seller-type of financing from their suppliers. The supplier of meat or fish may require that the purchase price be paid

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19 Id., at 30.
22 In some U.S. states, liquor and fishing licenses are deemed to be mere privileges that don’t grant property rights. See In re Chris-Don, Inc., 367 F.Supp.2d 696, 701 (D.N.J. 2005).
23 See Honduran RR, supra note 10, arts. 2(i) and 14(d). See also the definitions of “serial number” and “serial numbered property” in OAS Registry Regulations, supra note 5, art. 1.
within 7 days after delivery which allows the stall owner to resell the product and then repay the supplier. The interest rates that these suppliers charge are up to 80% a month. These stall owners are not able to access the traditional bank loan or a line of credit that might be available to other types of businesses at more reasonable rates. Honduran banks and cooperatives are reluctant to lend to the stall owners because they don’t maintain any records of their historical sales, they don’t advertise price and typically bargain with purchasers, etc. Lenders would want to see these stall owners properly document their cash flows in a formal yet simple manner. Accordingly, a set of simple accounting forms is a necessary bridge between a bank loan and the stall owner’s retail business.

Traditionally, small businesses have been reluctant to maintain any kind of records so as to avoid the payment of taxes. Only about 2.4% of all Honduran businesses and individuals pay income taxes. Failure to pay taxes would be a ground for rejecting a loan application in many jurisdictions, including the United States. In the jurisdictions where the collection rate is much higher, the government or other local taxing authorities typically enjoy a “super-priority” even over previously registered security interests. Tax authorities then oppose any reform proposal that seeks to subject tax liens to registration and priority rules of the secured transactions law. Due to the low tax collection rate in Honduras, the local taxing authorities did not oppose inclusion of tax liens in the secured transactions law. However, the claims of workers to unpaid wages and other benefits are excluded from the Honduran STL. Empirical evidence demonstrates that up to 7% of the debtor’s property to which secured creditors claim priority is distributed to

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24 NLCIFT, supra note 20, at 17.
25 NLCIFT, supra note 21, at 8.
26 See infra Part I.
27 NLCIFT, supra note 21, at 5.
28 Id.
29 See Honduran STL, supra note 10, art. 50 provides for the priority of tax and judgment liens. Even in countries where the government enjoys priority, there is much to be gained if it is willing to give up the priority as a result of which commerce improves through access to credit.
30 Id.
non-consensual claim holders. In many countries, it would be socially unacceptable to prioritize the claims of creditors over those of workers. All of these, and many other, factors must be thoroughly examined in the roadmap that will serve as the basis for future work, including drafting of the secured transactions law, registry regulations as well as discussions with local stakeholders.

D. Step 3: Identify Local Stakeholders/Counterparts

Successful implementation of a secured transactions reform project requires support from a number of key local stakeholders. It is important that not only the private sector bodies such as an association of banks and the chamber of commerce put their weight behind the reform, but also that promoters from the public sector be identified. Ideally, promoters should be grouped from all key areas of the public sector, including key officials of the executive branch and members of the parliament, as well as the judiciary. In Honduras, the private sector, the government as well key members of its Congress strongly supported the reform especially once they were made aware that U.S. banks would be willing to engage in secured lending to Honduran exporters directly or through their correspondent banks in Honduras. Nevertheless, this wide support could have been undermined if the judiciary failed to approve the overall legality and constitutionality of the Honduran draft STL law.

The Honduran Supreme Court regularly issues opinions on the constitutionality of proposed laws, especially of those that seek to amend or abrogate provisions of the Civil Code. In its opinion, the Honduran Supreme Court identified some provisions that needed to be modified to satisfy threshold constitutional requirements. However, the key provisions such as the requirement to register all security interests even if the creditor purports to retain title as well as all the extra-judicial enforcement remedies were upheld as constitutional. This opinion alleviated the concerns of many skeptics and opponents of the reform.

Inevitably, the reform has drawn some opposition, particu-
larly from those attorneys or legal professionals whose functions and roles were to be minimized under the new regime. For instance, because security agreements and registrations no longer require notarization under the Honduran STL, the notarial bar is losing revenues. Fortunately, the notarial bar has not proven powerful enough to stop or even delay the reform process.\(^34\) Therefore, these and other likely opponents must be identified and hopefully made to understand that they stand to gain more from a much larger volume of secured transactions than by insisting on counter-productive and costly formalities. In addition, it may be possible to find a new and productive role for these opponents. For example, as with UCC 9,\(^35\) the Honduran STL does not require that security agreements or registration forms be notarized.\(^36\) Yet, while these pre-existing requirements for notarization were eliminated, Article 71 of the Honduran STL authorized debtors, with assistance of a notary, to cancel a registration when the creditor refuses to do so and all the conditions for cancellation have been satisfied.\(^37\) Accordingly, the notaries are given a new role in the secured transactions framework. However, in this new role, notaries don’t add to the cost of credit and don’t delay the registration process.

E. Step 4: The Introduction of Foreign Best Practices

It is important for the local stakeholders and counterparts to get hands-on experience with some of the best banking, business and legal practices underlying the laws that will shape their own framework. The differences between an ordinary secured loan under UCC 9 and that under a Latin

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\(^34\) In contrast to the eventually cooperative attitude of Honduran lawyers, see the crippling effect of the mandatory registration of notarial deeds in the Peruvian law of secured transactions that is fortunately in the process of being revised. See Ley de Garantías Mobiliarias (Peru), Law 28677, published in the Official Gazette March 1, 2006 (hereinafter Peru STL).


\(^36\) See Honduran STL, supra note 10, arts. 11 and 44.

\(^37\) Id. art. 71. The notary must notify the creditor of the debtor’s request to cancel a registration. If the notary determines that all the conditions for cancellation of a registration have been satisfied, she will issue a notarial protocol that the debtor must append to the cancellation form. The registry shall not register the debtor cancellation form without the notarial protocol.
American law that does not follow the OAS Model Law are vast. A UCC 9 secured loan is much less cumbersome to execute than its pre-OAS Model Law Latin American counterpart. Unlike the latter, both the UCC 9 and the OAS Model Law do not require detailed descriptions of the collateral and secured obligations, signatures of the parties need not be notarized, registration may be effected easily via electronic means and for a low flat fee, and upon default the security interest may be enforced extra-judicially by the creditor. In contrast, a Latin American secured loan is characterized by excessive formalities, including notarization of signatures, detailed descriptions, expensive registration and cumbersome enforcement remedies.

In addition, Latin American bankers and lawyers are usually surprised to find out that their U.S. colleagues prefer personal property such as accounts receivable as collateral rather than real property for their loans. This preference for accounts receivable to real property as collateral is contrary to the perception and ingrained practices of many Latin American bankers and lawyers. It is important for them to see what a standard loan and security agreement look like, how quickly they get executed, how many and what types of borrowers have access to UCC 9 loans and how different a line of credit facility with its “after acquired debt and collateral” clauses is from the “opening of credit” contracts that they are accustomed to dealing with. Finally, they should become familiar with the functions of UCC filing offices; how it typically employs very few clerks without any legal education, how many registrations it processes on a daily basis and what fees it charges for the service. Again, the differences between a UCC filing office and the prototypical Latin American registry are significant. In the end, the Latin American bankers and lawyers should be able to realize the benefits of the proposed legal framework that will lead to expanded access to credit for borrowers and more business opportunities for lenders.

F. Step 5: Identify Core Features of the Secured Transactions Law

The comparative normative and roadmap studies identify the fundamental features and concepts, and set forth the parameters for the drafting of an efficient secured transactions law. Modern secured transactions laws, including the one drafted for Honduras follow the functional approach, mentioned earlier.\textsuperscript{41} The implementation of this approach requires that all mechanisms whose function is to secure the payment of a debt or satisfaction of an obligation be subject to the secured transactions law, and particularly its rules on perfection and priorities. Accordingly, Article 2 of the Honduran STL, similarly to UCC 9-109(a), sets forth the scope by defining the concept of a security interest with an “omnibus” clause that includes any contracts and clauses utilized to secure an obligation, sales with retention of title, financial leases, fiduciary trusts, outright sales and factoring of accounts receivables, etc.\textsuperscript{42}

Another important concept is the minimal exclusion of personal property assets from the scope of the law. Article 2 of the Honduran STL implements Article 2 of the OAS Model Law in that it allows creditors to take a security interest in any personal property that has some market value.\textsuperscript{43} In addition to the typical personal property assets such as equipment and accounts receivable, the Honduran STL also applies to fixtures and crops.\textsuperscript{44} These two types of assets should be addressed expressly because a competing and often superpriority interest in crops and fixtures might also be created under real property law. A creditor may take a security interest in these assets by recording a mortgage in the real prop-

\textsuperscript{41}The IFC Toolkit uses the term “substantive,” supra note 2, at 41. The UNCITRAL Legislative Guide uses the term “functional,” supra note 6, at 23.


\textsuperscript{43}See also Honduran STL, supra note 10, art. 3 that defines collateral.

\textsuperscript{44}Id., art. 5(2) for the definition of crops and art. 5(5) for the definition of fixtures.
However, many farmers in Latin America may not own the land on which the crops are growing or an irrigation system is to be affixed. Even if the borrower has title to the land, she might not be willing to mortgage it in order to access credit for business purposes, since one bad crop year may result in the loss of the land. Modern secured transactions laws allow creditors to take and perfect their security interests independently from the land or other real property. Such security interests do not affect the land and would be limited to fixtures and crops.

All security interests must be properly publicized in order to become effective against third parties. The OAS Model Law and the Honduran STL use the term “publicity” as the functional equivalent of the UCC 9 and PPSA “perfection,” and the UNCITRAL Legislative Guide’s “third-party effectiveness.” To achieve third-party effectiveness or perfection for a security interest, it must be made public so that third parties are put on notice of its potential existence. With limited exceptions, Article 19 of the Honduran STL requires that all security interests must be made public by registration, creditor’s possession or control of the collateral.

Registration is the most frequent form by which a security interest is made public. Accordingly, Title IV Chapter I of the Honduran STL deals exclusively with registration, including the establishment of the registry, its features, processes and information to be provided in registration forms. This Title of the Honduran STL draws heavily from the OAS Model Law and the OAS Registry Regulations. Specially, Article 42 of the Honduran STL identifies the fundamental features of the registry of security interests that include access by both electronic and paper-based means, a central database of all registrations for the entire

45 See U.C.C. § 9-334(b) (2010).
46 See U.C.C. § 9-334(a) (2010).
48 UNCITRAL Legislative Guide, supra note 6, Recommendation 29 similarly provides that “... a security right is effective against third parties only if it is created and one of the methods for achieving third-party effectiveness ... has been followed.”
49 See infra Part G.
territory of Honduras, and minimal validation or verification of information provided in the registration forms. Article 50 of the Honduran STL provides that the failure to properly publicize a security interest results in subordination of such security interest to other security interests or liens that have been made public. Loss of perfection and priority is strong enough incentive for the creditor to publicize its security interest.

The Honduran STL also provides for extra-judicial remedies that allow creditors to enforce their security interests without the necessity to obtain a court order.50 One of the main obstacles to accessing credit on reasonable terms is the cumbersome enforcement remedies upon default of the debtor. In countries with an inefficient and slow court system, by the time the creditor obtains a court order authorizing enforcement of the security interest the collateral is nowhere to be found or its value will have significantly deteriorated. Lenders factor these risks into the cost of credit, immediately reserve against such risks, increase the interest rate and more strictly monitor the borrower. Extra-judicial enforcement also benefits the debtor because secured creditors are more likely to obtain higher value for the collateral than public officers such as sheriffs who execute court orders.51 The ability to obtain a higher re-sale value in a foreclosure sale conducted by the creditor reduces the debtor’s responsibility for any deficiency and allows the creditor to quickly channel the funds to another borrower.

Unlike under UCC 9, the PPSA and the UNCITRAL Legislative Guide, the creditor is required by Article 58 of the Honduran STL to register an enforcement form in the registry of security interests and attach a copy of the security agreement authenticated by the debtor in order to proceed extra-judicially.52 This requirement was initially included in Article 54 of the OAS Model Law and implemented in Article 16 of the OAS Registry Regulations. Registration of an enforcement form ensures that third parties are put on notice of the pending foreclosure proceeding. If the debtor cures default prior to completion of foreclosure,

50Honduran STL, supra note 10, art. 55(1).
51IFC, supra note 2, at 55.
52Compare with OAS Model Law, supra note 5, art. 54.
the secured obligation will be reinstated and the enforcement form terminated.\textsuperscript{53}

However, a legal rule authorizing creditors to enforce extra-judicially is by itself insufficient to ensure that security interests can be enforced in an expedited manner. If the debtor resists extra-judicial enforcement, the creditor will not have any other option but to proceed pursuant to a judicial process.\textsuperscript{54} For this reason, a modern secured transactions law should also provide for expedited judicial remedies and other measure that minimize the potential for obstruction and delay in the process. In this respect, Article 59 of the Honduran STL, implementing Article 56 of the OAS Model Law, provides that the debtor must submit all her defenses within 3 days after she has received a notice of enforcement. Furthermore, the debtor may raise only the defenses set forth in Article 55(3) of the Honduran STL. These safeguards ensure that in case the debtor resists extra-judicial enforcement her strategic options to delay judicial enforcement are severely limited. The combination of extra-judicial remedies with access to expedited judicial procedures in the Honduran STL should be attractive to creditors and provide an excellent model for other Latin American countries.

This section highlighted only the core features of the Honduran STL. The drafter of the secured transactions law must also pay close attention to the rules establishing priorities among competing creditors, the applicable conflict of law rules and transitional rules. The transitional rules are of utmost importance because they provide for grandfathering of pre-existing security interests and require their registration under the new framework to maintain third-party effectiveness. These rules also provide for the issuance of registry regulations and the date for the law and regulations to take effect.\textsuperscript{55}

\textsuperscript{53}Honduran STL, \textit{supra} note 10, art. 61 and Honduran RR, \textit{supra} note 10, arts. 20–21.

\textsuperscript{54}See U.C.C. § 9-609(b) (2010) which provides that “a secured party may proceed . . . without judicial process, if it proceeds without breach of the peace.”

\textsuperscript{55}Honduran STL, \textit{supra} note 10, arts. 80–86.
G. Step 6: Design and Explain the Concept and Functions of a Notice-Filing Registry

The registry of security interests is a critical component of any secured transactions reform project.56 A registry that fails the standards of modern notice-filing systems can eliminate the effect of an otherwise modern secured transactions law. This has been the case both in Guatemala and Peru that reformed their secured transactions regimes but failed to establish adequate registries to support their respective modernized substantive legal frameworks.57 A notice-filing registry that requires the creditor or its agent to submit a simple notice in the form of a standardized registration form is a novel concept in civil-law jurisdictions with the tradition of constitutive registries whereby the creditor must submit the underlying loan documentation for scrutiny to the registrar and subsequent entry into the registry record. In such systems, registration is not independent of the creation of a security interest, and the security interest does not exist until the loan documentation is registered. The independence of notice from the underlying security agreement is a significant departure from this tradition that might be difficult to accept in Latin America. The local stakeholders need to be educated on the differences between the notice-filing and constitutive registries to appreciate the advantages of the former.58 UCC 9, the PPSA, the OAS Model Law, the OAS Registry Regulations as well as the UNCITRAL Legislative Guide provide for and recommend the establishment of notice-filing systems.59

It is therefore important that the local counterpart registrars get acquainted with the notice-filing type of registration system and embrace it. When the concept of notice-filing was first introduced in Honduras, the reaction


58 See NLCIFT, Comparative Analysis of Registry Systems, Deliverable #7 of the Contract for Consulting Services between the Millennium Challenge Account (MCA) — Honduras and the National Law Center for Inter-American Free Trade (April 2008) (on file with author).

59 For an overview of the notice system under the PPSA see RONALD C.C. CUMING, CATHERINE WALSH & RODERICK J. WOOD, *PERSONAL PROPERTY SECURITY LAW* 206 (2005).
from the Tegucigalpa Chamber of Commerce staff was not positive. However, gradually the Honduran registrars themselves became the strongest advocates of the notice-filing system and defended it against the critics. This conversion was facilitated by the registry’s design and development process. Yet, aside from its foolproof functionality, the registrars were happy to hear during their first training session that they would not be subject to administrative actions (ocursos administrativos) for failing to examine each registration form for its compliance with the STL or underlying contracts’ law, as is the case with their colleagues in the land registry.

With respect to the procurement of the registry software application, the country that is undertaking a secured transactions and registry reform has the following options: 1) purchase the registry software application; 2) become a licensee or sub-licensee of the application; or 3) develop the software application in-house.60 The Tegucigalpa Chamber of Commerce chose to have the registry system application developed in-house with assistance of a foreign expert. The application was developed from the very beginning with active participation of the Honduran registrars and other staff who were able to track its development and test the individual functions as they were being designed and implemented. This design and development process instilled pride of ownership in the local stakeholders which undoubtedly facilitated the acceptance of the notice-filing system.

The registry system application (the software that processes information provided in registration forms) must be installed on adequate hardware. Accordingly, it is important to determine whether the existing hardware that the entity designated to host the registry application has available is sufficient to support it.61 A study evaluating the hardware needs should take into account the estimated volume and types of registrations and on this basis determine whether


or not the infrastructure is sufficient. In addition, the expected number of registrations may be a benchmark for recommending the minimum registration fee that would be sufficient to recover the costs of design and development as well as to ensure future sustainability of the registry.62

Before the actual development commences, a detailed design document setting out the legal, functional and technical parameters for the future registry should be prepared.63 The technical part of the design document prepared for Honduras addressed three layers of a registry that included 1) the presentation layer that consists of the web interface that allows users to access the registry application; 2) the business layer that provides the logic used to complete registrations and retrieve search results; and 3) the data layer that is responsible for the storage and maintenance of registered information.64 The system must be designed to ensure that registered data is protected from corruption, theft and fraudulent modification. At the same time, particularly the presentation layer should be user-friendly and not overly complicated.

One of the user-friendly features of the Honduran registration system is its reliance on separate registration forms for different registration functions. Creditors must use a special registration form to submit an initial registration, a separate form to amend some information including to indicate an assignment, a separate form to continue the effectiveness of the registration, a separate form to terminate the effectiveness, etc. This is a departure from the UCC Financing Statement Amendment that includes checkboxes and fields to effectuate all types of amendments, including continuation and termination of the effectiveness.65 U.S. case law demonstrates that creditors occasionally select the wrong checkbox (e.g., termination instead of continuation) which may have

62Id., at 32–34.
63Id.
64Id.
65See U.C.C. § 9-521(b) (2010).
fatal consequences, including the loss of perfection and priority.66

The Honduran registry system incorporates a number of features that minimize fraud, corruption of registrars and also assist users in entering information into screens.67 The system does not allow registrars to change or delete any information provided in registration forms, access and alter any already-registered information or handle payments of registration fees. The duties and responsibility of registrars are merely administrative or clerical.68 This is also the norm set forth in Article 4 of the OAS Registry Regulations. What it means is that human beings are supposed to perform the same functions that the electronic registration system does: to ensure that all required information has been provided in a registration form without making any determination as to whether this information is accurate or legally valid. The Honduran registry is not only the first truly notice-filing system in Latin America, but its functions and features are also likely the closest to the UCC 9 and PPSA filing systems in the entire world. Other countries, not limited to those in Latin America and beyond should be encouraged to look to the Honduran registry as a model.69

H. Step 7: Identify Debtors and Collateral for the Purposes of Registration and Search

One of the most important features of a registration system is a rule that provides for adequate and reliable identification of debtors. Information provided in registration forms is stored and organized in the registry database by the debtor identifier.70 The identifier of the debtor may be a name or some identification number. Most systems, including the UCC and PPSA filing offices index records according

66 See In re Pacific Trencher & Equipment, Inc., 735 F.2d 362, 363 (9th Cir. 1984) and In re Kitchin Equipment Co. of Virginia, Co., 960 F.2d 1242, 1246 (4th Cir. 1992).
67 IFC, supra note 2, at 69 and 76.
68 Honduras RR, supra note 10, art. 7(c). See also UNCITRAL Legislative Guide, supra note 6, Recommendation 54(d) that provides “The registrar does not require verification of the identity of the registrant or the existence of authorization for registration of notice or conduct further scrutiny of the content of the notice.”
69 See further Dubovec, supra note 57.
70 UNCITRAL Legislative Guide, supra note 6, Recommendation 54(h).
to the name of the debtor because no unique and reliable identification number exists for debtors in these jurisdictions.\textsuperscript{71} The OAS Registry Regulations contemplate that registrations may be indexed and stored according to an identification number of the debtor.\textsuperscript{72} While in Canada and the United States unique identification numbers for debtors may not exist or cannot be used in public records (\textit{e.g.}, U.S. social security numbers), individual and company debtors in some Latin American countries commonly have a unique identification number (\textit{e.g.}, tax numbers of companies in Honduras).

In order to design a registration system on the basis of debtor identification numbers, first, the numbers must be unique to individual and company debtors. Second, the numbers cannot be easily changed. Third, they must be assigned by a public authority. Finally, they must be accessible to creditors. If identification numbers did not satisfy these requirements, the number-based system might not offer an advantage over a name-based system. If a debtor is to be identified by a number, the creditor or its agent need not guess what the debtor’s name sufficient for registration purposes is, what documentary source(s) indicates the sufficient name of the debtor, which components of the name are the first, middle and last names, whether the debtor has recently changed its name, whether the changed name is already reflected in the documentary source, etc.

A single unique identification number facilitates not only registration but also searching the database. A person would need to conduct a search only against a single identification number without having to run additional searches under different variations as is the case in the name-based systems. However, a number-based registration system is equally prone to errors as is the name-based registration system. A creditor or searcher may make a typographical error in a character as easily as in a digit. While a number-based system would “sensibly reduce” the risk of error and provide a higher degree of certainty as compared with the name-based system, it does not provide absolute certainty and immunity from errors.

In Honduras, all potential debtors are identifiable by

\begin{footnotesize}
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\item \textsuperscript{71}U.C.C. § 9-519(c)(1) (2010).
\item \textsuperscript{72}OAS Registry Regulations, \textit{supra} note 5, art. 12(II).
\end{itemize}
\end{footnotesize}
identification numbers. The system divides debtors into five different types: organization or business association, civil association, citizen/individual merchant, resident and non-resident. Honduran RR then define what the identification numbers for these types of debtors are (e.g., a passport number, tax number, etc.). In addition, registrants must identify Honduran debtors by a name and address. However, neither the name nor address constitutes a searchable criterion that determines the effectiveness of the registration. In other words, an error in the name or address will not render the registration ineffective as long as the identification number is correct.

In addition to being able to search the Honduran registry according to the debtor identification number, information in registration forms is stored and searchable according to the serial number of collateral. Article 2(i) of the Honduran RR defines serial-numbered assets that include vehicles, construction and agricultural equipment, licenses and permits. The scope is intentionally narrow so that serial numbers would not be required for household appliances, personal goods such as laptops as well as for goods that are held for sale as inventory. Article 1 of the OAS Registry Regulations defines serial numbered property in a similarly narrow fashion. Under the Honduran RR, the serial number must be entered correctly otherwise the registration will be ineffective. However, if the registration described other collateral such as accounts receivable in addition to the incorrectly identified serial-numbered asset, it would remain effective and the security interest perfected with respect to the accounts receivable.

For the collateral that does not fall under the definition of serial-numbered asset, Article 44(II) of the Honduran STL provides that such collateral may be described either generically or specifically. Accordingly, the substantive law recognizes generic descriptions, but has not gone as far as some other systems where the collateral may be described in a registration form super-generically as “all assets” or “all

\[^{73}\text{id.}, \text{art. } 2.\]
\[^{74}\text{id.}, \text{art. } 18.\]
\[^{75}\text{UNCITRAL Legislative Guide, supra note } 6, \text{ at 157.}\]
\[^{76}\text{Honduran RR, supra note } 10, \text{ art. } 18(c).\]
property of the debtor.\textsuperscript{77} The Honduran registry system also provides for an option to attach a document to the registration form. The attachment may be the security agreement, an invoice or whatever other document that may include a more detailed collateral description. In this respect, it is important to note that the Honduran RR follow Article 6(II) of the OAS Model Registry Regulations that allow for the registration of attachments but without any legal effect.\textsuperscript{78} In other words, if the registration form does not describe the collateral sufficiently, any description of the collateral included in an attached document will not cure this defect and the registration will remain ineffective.

Registration systems may be designed to retrieve either only exact or close matches of debtor identifiers. The search logic that the registration system uses to index and retrieve information thus may be either strict (exact matches) or flexible (close matches). If the registration system uses the strict search logic, for a registration to be effective the creditor must provide the debtor’s name or identification number without any mistakes or typographical errors. For instance, if the debtor’s name is John Smith but the creditor enters the name in a registration form as John Smitz, the searcher will not be able to retrieve the registration using John Smith as the search criteria. In contrast, the flexible search logic that retrieves close matches might locate the John Smitz registration form.

The registry design must choose the type of search logic that best reflects the local environment. The strict search logic is relatively harsh on creditors who make a mistake in the debtor’s identifier. As a result, the loan made to such a borrower will be unsecured due to a minor clerical error.\textsuperscript{79} The creditor’s right to collect from the borrower will be significantly impaired because it will be subject to the rights and priority of the insolvency trustee and other creditors. Secured creditors might be inclined to favor the flexible

\textsuperscript{77}See U.C.C. § 9-504 (2010).

\textsuperscript{78}Honduran RR, supra note 10, art. 6(b).

\textsuperscript{79}Some studies indicate that up to 50\% of the registered organization names in the UCC index do not match the name set forth in the formation documents, and up to 25\% of the registered organization names will not appear on a search of the correct debtor name using the standard search logic. See Paul Hodnefield, A Legislative Response to Revised Article 9 Debtor Name Ambiguity, 40 UCC L.J. 1 Art. 2 (2007).
search logic. Such logic might retrieve the registration that identifies the debtor incorrectly as John Smitz, but also a number of other close matches such as Johnny Smith, John Smit, etc. The number of close matches retrieved by such search logic may be, in some situations, quite extensive.\footnote{The Florida UCC filing system uses the flexible search logic that retrieves an alphabetical list of 20 entries with the exact or nearest match to the searched entry at the top of the search results screen. In re John’s Bean Farm Homestead, Inc., 378 B.R. 385, 388 (Bankr. S.D.Fla, 2007).} Then the question arises as to whether the registration is effective and whether the searcher acted reasonably under the circumstances \textit{i.e.}, whether the searcher has a duty to examine all close matches retrieved by the search.

These questions may be answered only by the court. The court will need to determine whether the searcher should have reviewed all the search results on the first page, whether the searcher should have also reviewed the registrations on the second search result page, on the 60th search result page, etc. U.S. courts answer these questions using the reasonably diligent searcher standard that is applied to the search result retrieved by the relevant UCC office’s official search logic.\footnote{See In re Summit Staffing Polk County, Inc., 305 B.R. 347, 355 (Bankr. M.D.Fla., 2003) and In re John’s Bean Farm Homestead, Inc., 378 B.R. 385, 392 (Bankr. S.D.Fla, 2007).} The U.S. courts decisions provide comfort to the lenders who can anticipate what kind of errors will render the financing statement ineffective and price the risk accordingly. Will a Honduran or other Latin American court be able to do the same and in a timely manner? In Honduras, the decision was made to design the strict search logic that would not require assistance of the courts to decide whether the registration is effective and whether the searcher acted reasonably under the circumstances. If the creditor makes a mistake in the debtor’s identification number, the registration shall not be retrievable and, thus, ineffective.\footnote{Honduran RR, \textit{supra} note 10, art. 18(a).} The search logic and not the courts will determine the effectiveness of a registration. These “decisions” will be made without any delay associated with the court process.

The system design and identification of Honduran debtors by unique numbers provides certainty to the user community. However, in some Latin American countries not all potential debtors may be identifiable by unique numbers. In that case,
the country would not have any other option but to use names of debtors as the indexing/search criteria. For guidance on the rules governing such a system, the country should look to the OAS Registry Regulations as well as the Model Registry Regulations being developed under the UNCITRAL Legislative Guide.83

I. Step 8: Formalize Cash Flows

Banks and other lenders evaluate potential borrowers on the basis of their ability to service and timely repay the loan. Collateral is only a secondary consideration but plays an important role in situations where the cash-flow of the borrower is not strong enough to qualify it for an unsecured loan. Banks require loan applicants to demonstrate their historical cash flows as well as their potential for future growth. Many SMEs in Latin America do not maintain any kind of record of their sales, purchases, costs and other expenses.84 Consequently, it is difficult for the lender to assess and price the risk of such a loan. Many Latin American SMEs are simply not used to documenting their cash-flow or are unable to do so.85 Some Honduran SMEs maintain basic books called libretas where they enter the names of credit customers, debts owed to suppliers, limited sales data, inventory, and other relevant information. These books are maintained in paper-based form because very few Honduran SMEs actually own and use a computer for business purposes.86 Only larger vendors maintain basic accounting records that are prepared with the assistance of credit unions and other financial institutions that already lend or contemplate lending to them. Honduran banks require borrowers to provide audited financial statements only for loans in excess of $500,000.87

Accounting forms that larger businesses utilize are too

85 Id.
86 NLCIFT, supra note 21, at 6.
87 Id., at 7.
complex for Honduran SMEs to complete. SMEs also don’t have the resources to hire an accountant or other professional to maintain books of the business. Accordingly, as part of the Honduran secured transactions reform project, simplified accounting forms were developed for SMEs to be able to easily document their cash-flows, sales, payables, receivables, etc. These forms allow SMEs to keep record of their historical and present sales and, thus, demonstrate to the lender the capability to repay the loan. In addition to documenting cash flows, these accounting forms may be used to record paid, earned but not yet paid and overdue receivables that the lender relies on as collateral and makes advances against. The borrower should record in the forms which receivables have already been earned, how many days from performance they are payable, by whom they are owed, etc. and submit them to the lender to request an advance. The borrower should also maintain a record of invoices, transportation documents or other bills to verify that the receivables actually exist. Accordingly, the simplified accounting forms developed for Honduran borrowers have a dual function: 1) to keep a record of cash flows and 2) to document receivables that are used as collateral for a loan. Sound accounting and recordkeeping practices will allow Honduran borrowers to more easily access credit.

J. Step 9: Attune the Regulatory Framework and Measure Impact

Secured lending is closely connected to the regulatory framework under which the banks and other lenders (e.g., cooperatives) operate. Central Banks and other regulators typically impose restrictions (e.g., by raising reserve requirements) and conditions on the type and volume of loans that regulated institutions may provide. These restrictions prevent the creation of bubbles, concentration of credit in particular sectors of the economy and keep the banks’ balance sheets healthy. In addition, regulation foster transparency of information about financial products that lenders

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88 Id., Annex I Model Financial Statements/Forms and Supporting Schedules.

record in their balance sheets. One of the roles of the regulator is to determine whether the regulated bank properly classifies or grades its loans in terms of the degree of risk involved. If the regulator disagrees with the bank’s assessment, it may order re-grading of the loan which would in turn increase the reserve requirements. Such increase of reserves will reduce the availability of funds for other loans.

For instance, as of December 2010, 17 commercial banks operated in Honduras. The Honduran regulator requires banks to set aside 100% reserves against loans that are 180 days overdue.

An overly restrictive regulatory framework might undermine many benefits gained through the implementation of a modern secured transactions legal framework. While lenders might be encouraged by the new legal framework and feel comfortable to loan, they would not be able to do so if the regulator imposed strict reserve requirements against secured loans. Reserve requirements and other limitations on lending are necessary in order to avoid overabundance of credit, but must be set and administered in a sensible and flexible manner. Accordingly, successful implementation of the secured transactions reform project requires close cooperation with the regulatory bodies so that they appreciate the impact of the reform on the volume of lending and related practices.

The cooperation of the regulator is also useful in terms of collecting data on the volume of loans facilitated by the reform. It is essential that the impact of the reform is measurable. The regulator has access to the relevant data critical to evaluate the impact of the reform and contrast it with the volume of lending under the pre-existing framework. Data documenting the volume of loans may also be available

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90 Kozolchyk & Wilson, supra note 1, at 19.
91 NLCIFT, Banking Regulation, Background and Plan of Action for Future Activities, Combined Report Deliverable #27 and Deliverable #30 of the Contract for Consulting Services between the Millennium Challenge Account (MCA) — Honduras and the National Law Center for Inter-American Free Trade, at 28 (August 2010) (on file with author).
93 NLCIFT, supra note 21, at 4.
94 IFC, supra note 2, at 98.
through the local banking association. The Honduran Banking Association (AHIBA) measures weekly and monthly volume of loans extended by its members. For the month of February 2011, the first month of operation of the Honduran registry, the volume of loans increased by 5% from February 2010.\textsuperscript{95} However, in Latin America, lenders are not limited to regulated banks and significant lending may be ongoing outside the official banking channels through credit unions, cooperatives, suppliers and other unregulated lenders. The volume of such lending may be difficult to measure because these lenders may not be subject to any reporting requirements.

The registry of security interests may be another source of relevant data to evaluate the impact of the reform. Although the Honduran registry generates regular reports on the number and types of registrations, these reports do not reflect the actual amounts loaned to borrowers. Nevertheless, registration numbers may be indicative of the success of the reform. While in Guatemala for the entire year of 2009 only 654 registrations were made, the registry in Bosnia & Herzegovina processed almost 12,000 registrations in the same period.\textsuperscript{96} In the first three months of the operation of the Honduran registry, the number of registrations already exceeded the number of registration in Guatemala for the entire year of 2009. The Tegucigalpa Chamber of Commerce estimated that 10,000 registrations would be made by the end of 2011.\textsuperscript{97} Nevertheless, there is no substitute for the data that indicates the actual lending activity and the types of loans. Regulators thus play an important role not only in setting forth adequate regulatory parameters for secured loans but also in collecting data on the volume of lending.


\textsuperscript{96}Betina Hennig, Worldwide Collateral Registries Survey 12 (unpublished presentation at the World Bank Group, Financial Infrastructure Week, Rio de Janeiro, March 14–17, 2011, on file with author). This comparison is noteworthy not only for the great disparage between the number of registrations but also for the fact that the population of Guatemala is 14 million while that of Bosnia & Herzegovina is less than 4 million. See http://www.worldatlas.com/aatlas/populations/cutypopls.htm.


The reform project, from its very beginning, should contemplate training sessions for the relevant stakeholders such as lenders, lawyers, judges and regulators.

Trainees should not only be introduced to the fundamental concepts and underlying principles of the secured transactions law such as the functional nature of the security interest and notice-filing system, but also be educated on the application of the new legal framework in the day-to-day practice. For instance, the traditional practice in Latin America is to describe the collateral in security agreements and registration forms in detail.

Article 11(4) of the Honduran STL provides that a generic description of the collateral is sufficient for the purposes of executing an enforceable security agreement. Honduran lenders may not be confident whether an “all inventory,” “all present and after-acquired inventory,” “all inventory owned by the debtor,” “all inventory including t-shirts and pants” description is sufficient under the new legal framework. Accordingly, trainees should be introduced to sample security agreements as well as the actual ones used by lenders that operate under a similar legal framework.

Participants in workshops and training sessions should be also educated on the use of the registry and actual submission of registrations. For instance, a typical Latin American registry would not process registration documents unless they have been properly signed by the debtor.

The Honduran STL does not require that the registration form be signed by the debtor or the secured creditor for that matter. Instead, Article 43 of the Honduran STL requires that the creditor obtains an authorization from the debtor to effectuate a registration. This authorization may be granted in the security agreement when it is signed by the debtor or

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98 See IFC, supra note 2, at 91.
99 Reglamento del Registro de Prendas sin Desplazamiento (Chile), Decree 39.792, published in the Official Gazette October 23, 2010, art. 5.
100 Compare with U.C.C. § 9-108 (2010).
101 Peru STL, supra note 34, art. 34.
in a separate document.\textsuperscript{102} Honduran and other Latin American lenders might not know what formalities and language an authorization to effectuate a registration should include or might not be confident that the language they intend to use for these purposes is sufficient under the Honduran STL.

Experienced U.S. and Canadian bankers that are familiar with lending under modern secured transactions legal framework should be brought in to the country to describe their loan application, approval, underwriting, monitoring and enforcement practices. These discussions might not be related to the interpretation and application of the substantive secured transactions law but rather geared towards modernization of lending practices. For instance, at the outset and throughout the loan relationship it is important for the lenders to be able to have access to adequate information to properly identify the risks involved and price the cost of the loan, \textit{i.e.}, to set and adjust the maximum limit on the line of credit, interest rate, etc. In addition, lenders should be able to properly monitor the borrower so as to prevent fraud, deterioration of the collateral or making advances when the borrower is unable to remain current on its installment payments. The lender should be able to react quickly, re-classify the loan as high risk and reserve sufficient capital against future losses. Three separate training sessions, covering different subjects, were attended by about 70 Honduran trainees that included lawyers, notaries, judges but also bankers and regulators.\textsuperscript{103}

Lending practices related to specific industries of importance to the Honduran economy such as agriculture must be specifically addressed in training as well. For instance, the practice of making advances to farmers only gradually corresponding to the production cycle should be explained. The lender should take a security interest in existing and future farm products but should not make an advance in excess of what is necessary to prepare the land for planting. Under the agricultural loan facilities, lenders make a line of credit

\textsuperscript{102}See also UNCITRAL Legislative Guide, \textit{supra} note 6, Recommendation 71 that provides “The law should provide that registration of a notice is ineffective unless authorized by the grantor in writing. The authorization may be given before or after registration. A written security agreement is sufficient to constitute authorization for the registration.”

\textsuperscript{103}See \url{http://www.ahiba.hn/servicios/capacitaciones/59-diplomado-en-garantias-mobiliarias}.  

\textsuperscript{102}\textsuperscript{103}
available that is drawn upon by the farmer and eventually reduced to zero when the crop has been harvested and readied for sale. No advances should be made against the crop that the farmer uses to feed his animals or for consumption purposes. Training of this kind should continue even after the completion of the reform project in order to develop best lending practices.

L. Step 11: Prepare and Continuously Update Sets of Best Practices

An important component of a successful secured transactions reform project as envisaged by the NLCIFT is development and collection of best practices that relate to lending. Registration, accounting, underwriting and collateral evaluation practices will gradually develop under the new legal framework. It will be important to monitor the practical application of various aspects of the secured transactions reform and identify both bad and good practices. The best practices should be identified and collected in the form of manuals and model codes and these manuals should be regularly updated.

These formally recognized practices supplement the existing statutory legal framework. Some practices have direct impact on the proper application of the particular legal rule while some relate to the conduct of business. Article 66 of the Honduran STL entitles the debtor to claim damages for the loss suffered as a result of abusive conduct of the secured creditor in the enforcement of a security interest. It is an equivalent of the UCC 9-609 requirement to proceed without breach of the peace and the debtor’s right to claim damages under UCC 9-625 for the creditor’s failure to comply with

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104 NLCIFT, supra note 91, at 29.
UCC 9. For instance, when the creditor intends to enforce its security interest by repossessing the collateral, it might not be clear which conduct would violate Article 66 of the Honduran STL. The conduct may range from getting the debtor to voluntarily turn over the collateral to forceful entry onto the debtor’s premises in order to effect repossession. While voluntary surrender might be the best practice under the circumstances, forceful entry or even causing injury to the debtor might be an example of bad practice sanctionable by law.

Practices should also be collected with respect to operation of the registry. For instance, presently, the Honduran RR do not provide for the amendment function that would allow parties to register subordination of priority. In this respect, the Honduran registry design was influenced by UCC 9 filing systems under which the UCC Financing Statement Amendment does not include an item or a checkbox to indicate subordination. For U.S. creditors to “file subordination,” they may utilize Item 8 of the UCC Financing Statement Amendment that is reserved for new information related to collateral description. In contrast, Section 45(6) of the British Columbia PPSA expressly contemplates registration of subordination, and registration forms include the relevant checkbox to indicate subordination. Subordination is an amendment function also under Article 15(IV) of the OAS Registry Regulations. Honduran creditors might be inclined in the future, if relevant practices develop, to have the registry include a specific amendment function that would allow them to register subordination of priority.

Other practices relate to the actual loan application, approval, collateral evaluation or monitoring of the debtor’s activity. For instance, lenders may require their borrowers who are involved in agriculture to document their growing

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107 UNCITRAL Legislative Guide, supra note 6, Recommendation 131 provides that “... a person must enforce its rights and perform its obligations under the provisions on enforcement in good faith and in a commercially reasonable manner.”


109 See also UNCITRAL Legislative Guide, supra note 6, Recommendation 94 that provides for voluntary subordination of priority but does not require a registration thereof.
processes, inputs and pesticides that they use. This information will allow the lender to more accurately determine the market value of such collateral. For these purposes, lenders may prepare a standard document in which the farmer will enter this information. Many lenders are not familiar with the type of product that their borrowers sell and on which they rely as collateral. In cooperation with the fish industry, lenders should prepare a manual that will allow easy classification of the fish. Lenders will thus be able to estimate the market value of their collateral.

These sets of best practices should reduce the number of disputes and court litigation. Consequently, lenders will be more confident in lending and may even reduce the cost of credit due to the elimination of certain risks. This section identifies only a few areas where best practices may play a crucial role. Countries should apply this best practice-oriented approach to other aspects of a secured transaction such as the improvement of accounting forms or licensing of stalls in public markets. Best practices have an enormous potential to increase the collateral value of personal property assets and reduce litigation.

M. Step 12: Modernize Related Areas of the Law

The secured transactions law is closely related to and impacts other areas of law, especially the law of bankruptcy, securitization and cross-border financing. A secured transactions law typically ceases to apply, or applies to a very limited extent,110 when the debtor files for bankruptcy protection. Debtors frequently file for bankruptcy to delay or entirely stop enforcement of a security interest under the secured transactions law. As long as the bankruptcy law provides for orderly reorganization or liquidation that is efficiently administered by a trustee under supervision of the bankruptcy court, the secured creditor will eventually receive the value that it was entitled to at the commencement of the bankruptcy. However, if the country has an antiquated bankruptcy legal framework that is inefficiently administered, the secured creditor might not receive what it bargained for. Accordingly, it is important to undertake a parallel reform of the bankruptcy law to ensure that the gains provided to the

110See U.S. Bankruptcy Code, U.S.C. 17 § 362(b)(3) (2005) that allows creditors to perfect certain types of security interests after the bankruptcy petition has been filed and the automatic stay became effective.
parties through the secured transactions law are not lost in bankruptcy.\footnote{NLCIFT, supra note 106, at 32.}

Another area of great interest to a country that seeks to modernize its secured lending framework is securitization. Securitization is a process that involves raising capital by issuing securities, typically bonds that are secured with underlying cash flow generating assets such as mortgage loans or credit card receivables.\footnote{Frank J. Fabozzi & Vinod Kothari, \textit{Securitization: The Tool of Financial Transformation}, Yale ICF Working Paper No. 07-07.} When originators of loans are able to resell them in the secondary market, they obtain funds in exchange that may be used to extend additional loans. Adequate regulatory framework should be in place so as to avoid the consequences of the recent credit crisis caused primarily by the securitization of sub-prime mortgage loans.\footnote{See Dodd-Frank Wall Street Reform and Consumer Protection Act Pub.L. 111-203, H.R. 4173 (July 21, 2010) that requires the originators to retain 5\% of any assets included in a securitization.} Such a framework should allow a number of lenders, particularly those that are in the business of car financing, to access additional funding that may be turned into secured loans. Presently, there is no such legal framework for securitizations in Honduras.

The secured transactions law regulates primarily domestic transactions, but it also includes conflict-of-laws rules that determine which jurisdiction’s law applies when the debtor or collateral is located in foreign country.\footnote{See OAS Model Law, supra note 5, Title VIII.} However, conflict-of-law rules are insufficient to sufficiently regulate truly cross-border transactions that involve sellers, buyers, multiple lenders and highly mobile collateral. The International Institute for the Unification of Private Law (UNIDROIT) produced two important international conventions that facilitate financing secured with specific assets. The 2001 Cape Town Convention on International Interests in Mobile Equipment (Cape Town Convention) facilitates financing of highly mobile and valuable equipment such as airframes, engines, helicopters, railway rolling stock and

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space assets. These types of assets may be financed under the Cape Town Convention in the form of a security interest, a title reservation agreement and lease. Widespread ratification of the Cape Town Convention will eliminate a number of significant legal and financial risks for the financiers and users of such equipment. Although Honduras has not yet ratified the Cape Town Convention, a number of countries in Latin America already have.

The other important international instrument prepared under the auspices of UNIDROIT is the 2009 Convention on Substantive Rules for Intermediated Securities (Geneva Securities Convention). The Geneva Securities Convention provides a framework for the holding of securities in accounts with intermediaries. Its scope and coverage is not comprehensive, and with respect to a number of issues it defers to the applicable domestic law. Chapter V of the Geneva Securities Convention deals specifically with the taking of security interests in intermediated securities. Many developing economies don’t have any or sufficiently robust securities market to draw benefits from the ratification. Nonetheless, as their economies grow and securities markets mature, the Geneva Securities Convention would be an excellent source not only to govern cross-border

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116 Id., art. 2(2).
118 In Latin America, Colombia, Cuba and Mexico ratified the Cape Town Convention while Chile only signed it. See http://www.unidroit.org/english/implement/i-2001-convention.pdf.
transactions, but also to use as a model for the reform of domestic legislation.

N. Final Remarks

The time and cost needed to implement a secured transactions reform project are unpredictable and depend on a number of variables.\textsuperscript{122} The result is also uncertain and a number of reform projects have failed to achieve the desired benefits. The steps outlined in this article reflect the experience of the NLCIFT in several Latin American countries and should facilitate implementation of a functional system for secured credit, especially by using Honduras as a model. Nevertheless, every country has its own peculiar legal structure, lending practices and socio-economic conditions. For instance, in some countries the public markets with thousands of stalls may not exist or operate under different conditions than those described in Honduras. The roadmap study must identify the typical form of businesses and potential borrowers, and analyze whether access to credit would allow these “street vendors” to grow and even stimulate the establishment of centralized public markets. The roadmap may also determine that the technological infrastructure of the country is mature enough to provide access to the registry only by electronic means as was recently done in Mexico. The steps and processes identified in this article should be executed keeping the local socio-economic, legal and financial conditions in mind.

What is the lesson for other Latin American countries that share with Honduras many socio-economic and legal characteristics? The environment in those countries is conducive to a reform that facilitates access to credit and stimulates economic development. Given the export-oriented nature of economies in Latin America and their reliance on agricultural products, the steps outlined in this article provide a suitable implementation guide for these countries. Access to credit will allow consumers to purchase more items and increase the quality of life. It will also allow many individuals to start a business, facilitate migration of existing informal and small businesses into formal and employment-generating entities and reduce the cost of credit for everybody. One can only hope that the success in Honduras is just a beginning and a wave of secured transactions reforms in Latin America will follow.

\textsuperscript{122}IFC, supra note 2, at 23.