

A World Bank Group Flagship Report



Doing Business 2018

Getting Credit – Legal Rights /Pakistan



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Department

June 1, 2018

- I. Why does it matter?**
- II. What does it measure – and what does it not?
- III. Methodology changes in the past 5 years
- IV. What are the main findings in DB18?
- V. Historical trends
- VI. What are the main findings in DB18 for Pakistan?



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Why does **Legal Rights** matter?

The SME's & the lender's perspective

SME's

- Affordable credit.
- Collateral.
- **Immovable property:** Most SMEs do not **own real estate**.
- **Movable property:** In developing countries movable property is not accepted due to a **lack of legal framework**.

Creditors – cost of credit

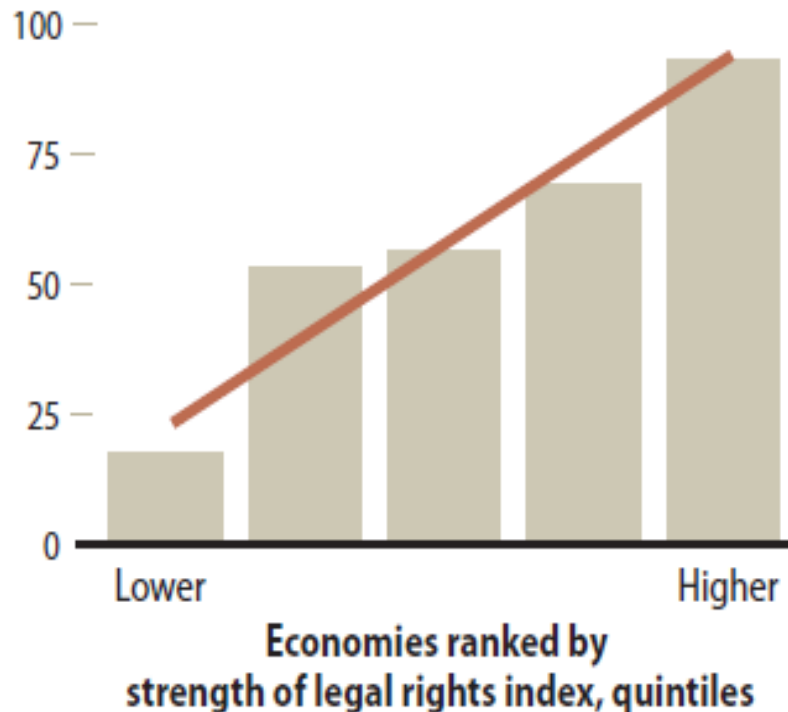
- The **lender's cost** of capital, transaction costs to make the loan, and risks the loan will **not be repaid**.
- **Impact:** smaller availability, shorter loans at higher interest rates.
- If **creditors** have **priority over other creditors** or more bargaining power to force repayment or take control of the firm, they will **extend credit on more favorable terms**.

Why does **Legal Rights** matter?

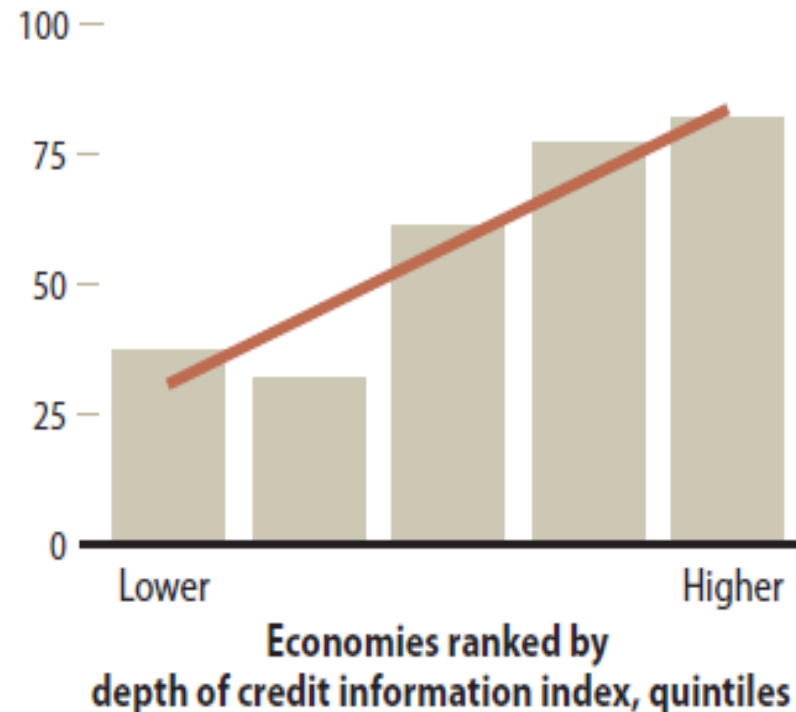
Stronger legal rights and more credit info equals more credit

Stronger legal rights and more credit information are associated with more credit

Private credit as % of GDP



Private credit as % of GDP



Note: Relationships are significant at the 5% level and remain significant when controlling for income per capita.

Source: Doing Business database; World Bank, World Development Indicators database (2008).

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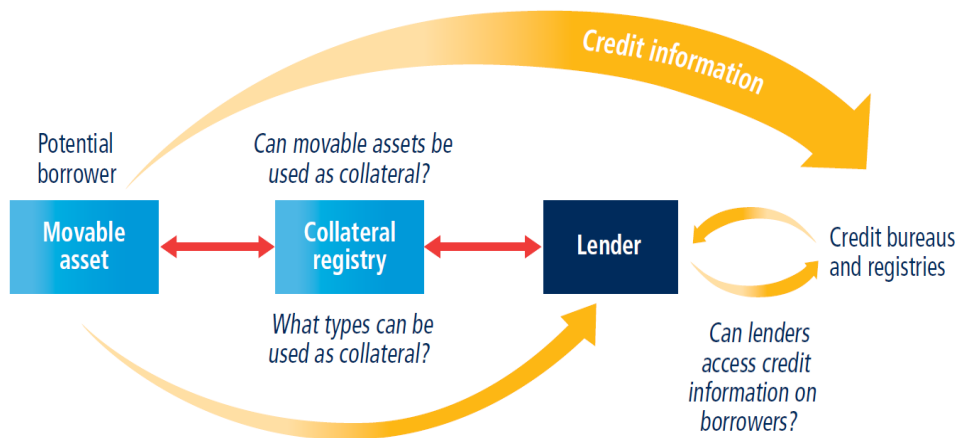
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How is the ranking on Getting Credit constructed?

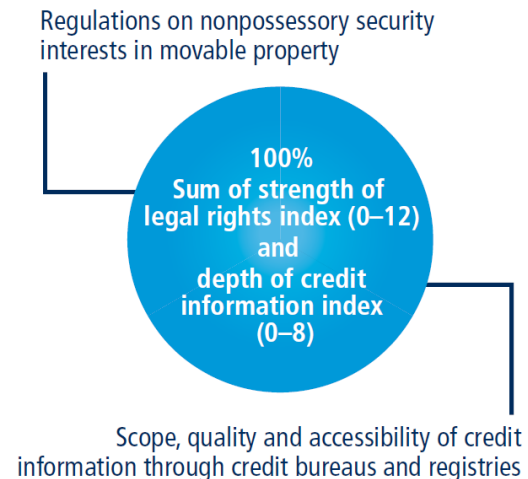
Based on strength of legal rights and depth of credit information

- ✓ Do lenders have credit information on entrepreneurs seeking credit?
- ✓ Is the law favorable to borrowers and lenders using movable assets as collateral?



Getting Credit: collateral rules and credit information

Rankings are based on distance to frontier scores for the sum of two indicators



What do the Getting Credit indicators measure?

Strength of Legal Rights index (0–12)

Protection of rights of borrowers and lenders through collateral laws

Protection of secured creditors' rights through bankruptcy laws

Depth of Credit Information index (0–8)

Scope and accessibility of credit information distributed by public credit registries and private credit bureaus

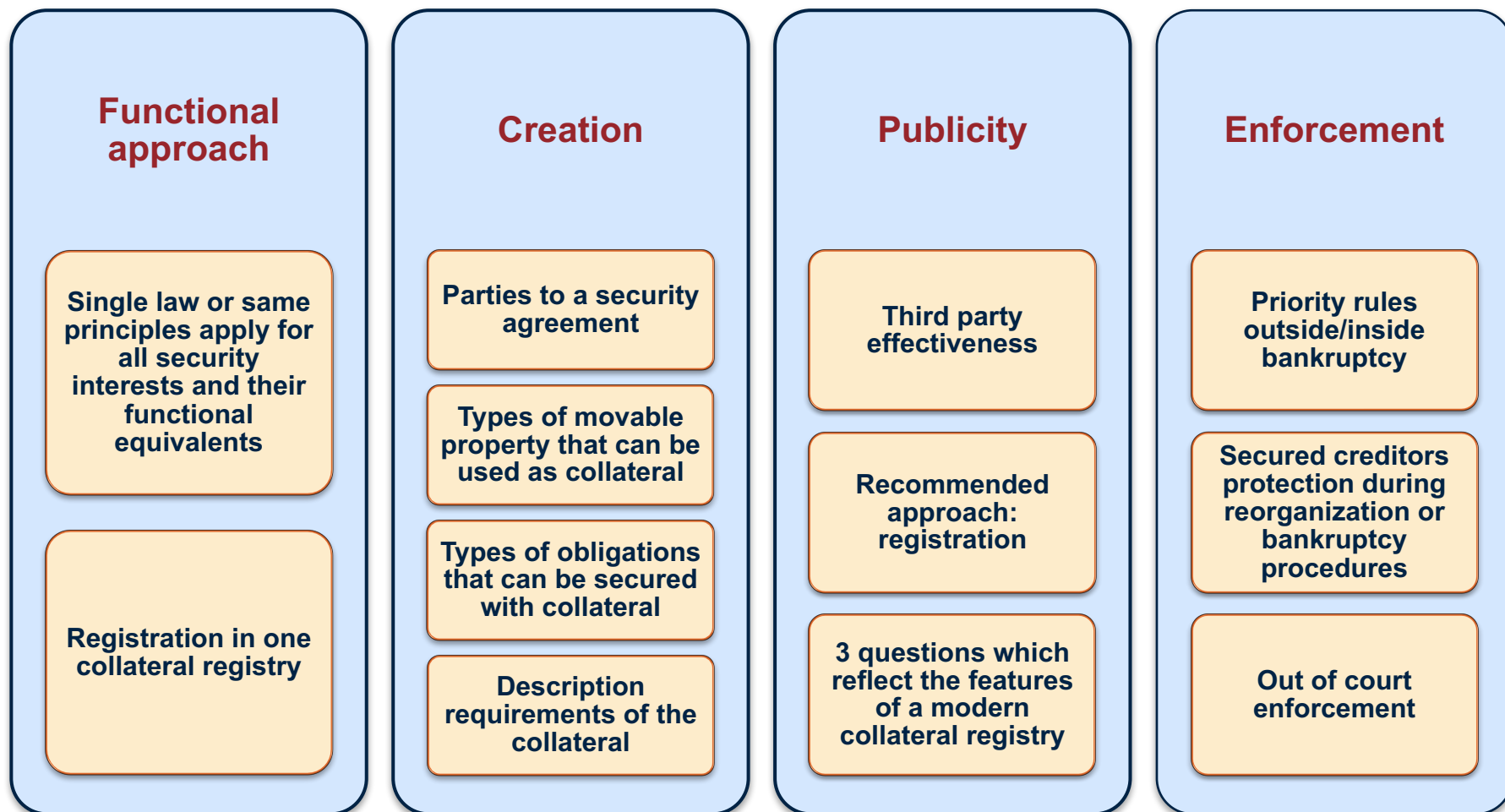
Public credit registry coverage (% of adults)

Number of individuals and firms listed in a public credit registry as % of adult population

Private credit bureau coverage (% of adults)

Number of individuals and firms listed in largest private credit bureau as % of adult population

What is measured by **Legal Rights?** Secured Transactions system & Credit cycle of Non Possessory Security Interest (NPSI)



What is covered by **Legal Rights**?

- Functional equivalents to traditional type of **security interests**: incorporated & non incorporated entities.
- One legal mechanism: NPSI → **Focus on LLCs (SMEs)**.
 - ✓ **Scenario A** (security rights in a single category of **movable** assets).
 - ✓ **Scenario B** (security rights in a combined category of **movable** assets).
- Security rights in **future and after-acquired** assets and automatic extension to products proceeds and replacements.
- General description of **debts and obligations**.
- Collateral registry for movable assets for both **incorporated** and **non-incorporated** entities:
 - ✓ **Unified.**
 - ✓ **Notice-based.**
 - ✓ **Online.**

What is covered and what is not covered in Legal Rights?

What is covered:

- ✓ Secured creditors priority outside bankruptcy and during liquidation.
- ✓ Secured creditors' exemption from automatic stay on enforcement procedures in reorganization (grounds for relief; time limit on stay).
- ✓ Out of court enforcement of security agreement (public and private sale).

What is not covered:

- ✓ No immovable property or specialized assets (aircrafts, ships, bonds, shares, IP rights).
- ✓ Does not measure practice: contractual liberty is considered a given by *Doing Business*. The law is the standard that dictates the scores.

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Methodology additions and changes in *Doing Business 2015*

- **Functional equivalents** to traditional type of security interests:
 - ✓ Incorporated & non incorporated entities.
- Collateral Registry for **movable assets** for both incorporated and non-incorporated entities:
 - ✓ Unified + Notice-based / Online.
- **Automatic stay** during reorganization proceedings:
 - ✓ Prescribe a **short time limit** of the stay.
 - ✓ Stipulate a **relief of the stay** when the collateral is not needed for the reorganization or when the stay poses a great risk to the existence of the collateral.
- **Out of court** enforcement:
 - ✓ **Public and private sales and/or automatic appropriation** of the encumbered asset upon default of the debtor.

Methodology additions and changes in *Doing Business 2015*: 10 aspects related to legal rights in collateral law and 2 in bankruptcy law

Strength of legal rights index (0-12)

Does an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets exist in the economy?



Does the law allow businesses to grant a non possessory security right in a single category of movable assets, without requiring a specific description of collateral?

Does the law allow businesses to grant a non possessory security right in substantially all of its assets, without requiring a specific description of collateral?

May a security right extend to future or after-acquired assets, and may it extend automatically to the products, proceeds and replacements of the original assets?

Is a general description of debts and obligations permitted in collateral agreements; can all types of debts and obligations be secured between parties; and can the collateral agreement include a maximum amount for which the assets are encumbered?

Is a collateral registry in operation for both incorporated and non-incorporated entities, that is unified geographically and by asset type, with an electronic database indexed by debtor's name?



Does a notice-based collateral registry exist in which all functional equivalents can be registered?



Does a modern collateral registry exist in which registrations, amendments, cancellations and searches can be performed online by any interested third party?



Are secured creditors paid first (i.e. before tax claims and employee claims) when a debtor defaults outside an insolvency procedure?

Are secured creditors paid first (i.e. before tax claims and employee claims) when a business is liquidated?

Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors' rights by providing clear grounds for relief from the stay and sets a time limit for it?



Does the law allow parties to agree on out of court enforcement at the time a security interest is created? Does the law allow the secured creditor to sell the collateral through public auction and private tender, as well as, for the secured creditor to keep the asset in satisfaction of the debt?



Score (number of "yes" responses) = 12

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Top performers in 2016/17

Getting Credit – Legal Rights



Colombia



Montenegro



New Zealand



Brunei Darussalam



Cambodia



Micronesia Fed. Sts



Australia



United States



Vanuatu



Costa Rica

Global good practices

- ✓ Establishing a functional approach to secured transactions
- ✓ Allowing a general description of collateral
- ✓ Maintaining a unified registry
- ✓ Protecting secured creditors' rights during an automatic stay when a debtor enters a court-supervised reorganization procedure
- ✓ Allowing out-of-court-enforcement

Reforms to strengthen rights of borrowers and lenders in 2016/17

Strengthening legal rights of borrowers and lenders

Created a unified and/or modern collateral registry for movable property

Belarus, Brunei Darussalam, Kyrgyz Republic, Malaysia, Mongolia, Nepal, Nigeria, Russian Federation, Samoa, Turkey, West Bank & Gaza, Zambia

Samoa strengthened access to credit by adopting a new law on secured transactions that establishes a **modern and centralized collateral registry**.

Introduced a functional and secured transactions system

Brunei Darussalam, Mongolia, Nepal, Nigeria, Samoa, West Bank & Gaza, Zambia

West Bank and Gaza strengthened access to credit by adopting the Security Interests in Moveable Property Act. The new law on secured transactions implements a **functional secured transactions system**. The **law regulates functional equivalents to loans secured with movable property**, such as financial leases and sales with retention of title.

Allowed for general description of assets that can be used as collateral and expanded range of movable assets that can be used as collateral

Albania, Thailand, West Bank and Gaza

Albania implemented new laws which allow for **the general description of assets granted as collateral**.

Expanded range of movable assets that can be used as collateral

Thailand, Vietnam

Thailand introduced a new law that broadens the **scope of assets** which can be **used as collateral** to secure a loan.

Granted absolute priority to secured creditors or allowed out-of-court enforcement

Albania, Brunei Darussalam, India, Kosovo, Malawi, Thailand, Turkey, West Bank & Gaza

Turkey introduced a new law that **allows out-of-court enforcement**.

Granted exemptions to secured creditors from automatic stay in insolvency proceedings

India, Kosovo, Thailand

Kosovo adopted a **new law on bankruptcy** that contemplates **protections for secured creditors** during an automatic stay in reorganization proceedings.

32 economies obtained all three points in the questions relevant to collateral registries

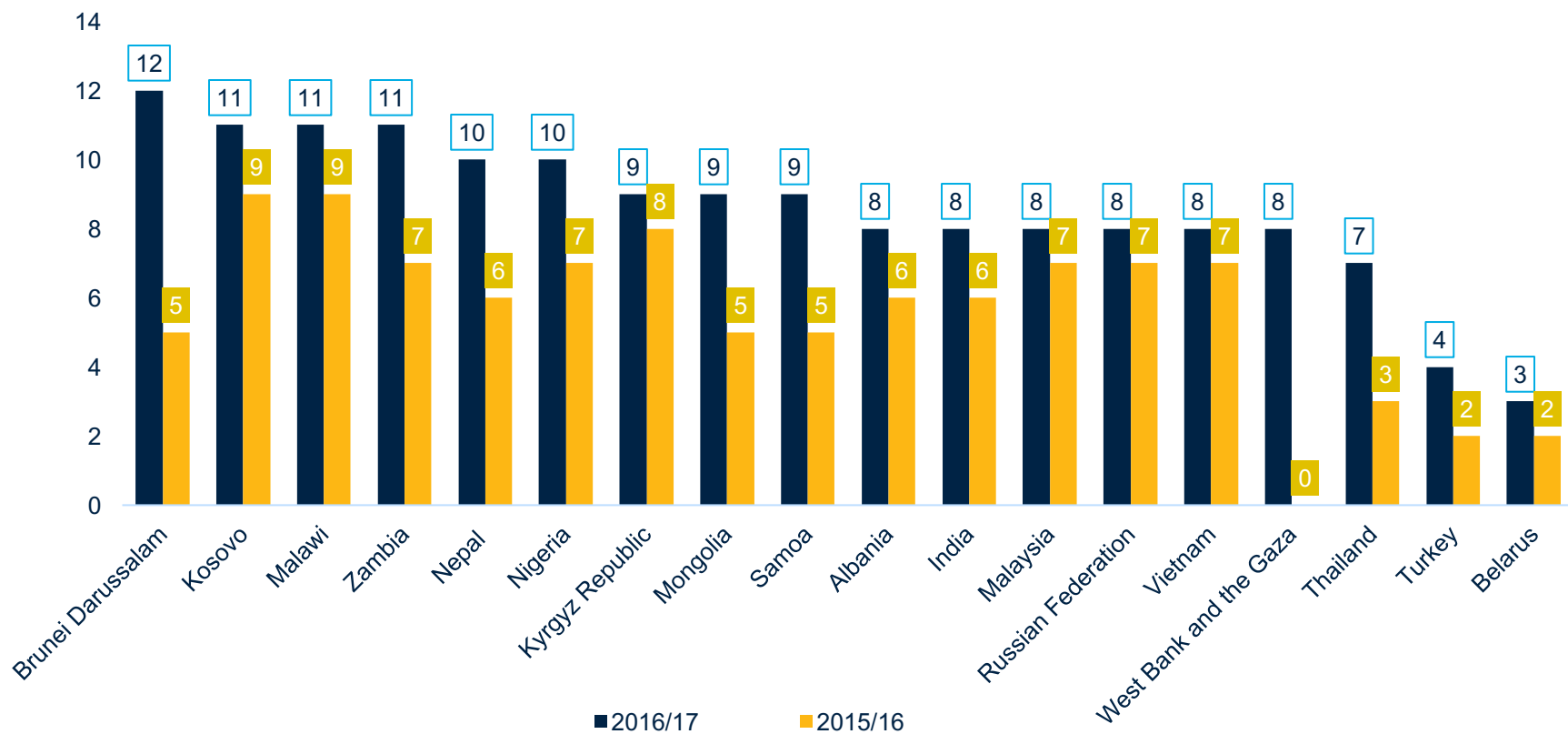
Economy	Economy
Afghanistan	Mexico
Australia	Micronesia, Fed. Sts.
Bosnia and Herzegovina	Mongolia
Brunei Darussalam	Montenegro
Cambodia	Nepal
Colombia	New Zealand
Costa Rica	Nigeria
El Salvador	Palau
Gambia, The	Papua New Guinea
Honduras	Samoa
Hungary	Solomon Islands
Jamaica	Tonga
Lao PDR	Uzbekistan
Liberia	Vanuatu
Malawi	West Bank and Gaza
Marshall Islands	Zambia

Features measured

- In operation for both **incorporated and non-incorporated entities**
- **Unified** geographically and by asset type
- **Electronic database** indexed by debtor's name
- **Notice-based**
- All **functional equivalents** can be registered
- **Online:** registrations, amendments, cancellations and searches can be performed by any interested third party electronically

18 economies implemented reforms on the strength of legal rights index in 2016/17

Reformers in strength of legal rights (0-12)



Source: Doing Business database.

Good practices to follow

Practices	Economies	Examples
Establishing a functional approach to secured transactions	54	Australia; Guatemala; Peru; Palau; Vietnam; Mali; Kosovo
Allowing a security right in a single category of assets	117	Gabon; Canada; India; Romania; Rwanda; Kenya; United Kingdom
Maintaining a modern and online collateral registry	55	Jamaica; Lao PDR; Australia; Hungary; Cambodia; Bosnia and Herzegovina; Honduras
Protecting secured creditors' rights during automatic stay when a debtor enters a court-supervised reorganization procedure	28	Albania; Armenia; Finland; Greece; Latvia; Philippines; Moldova
Allowing out of court enforcement	131	Brazil; Austria; Cameroon; Dominica; France; Ireland; Japan

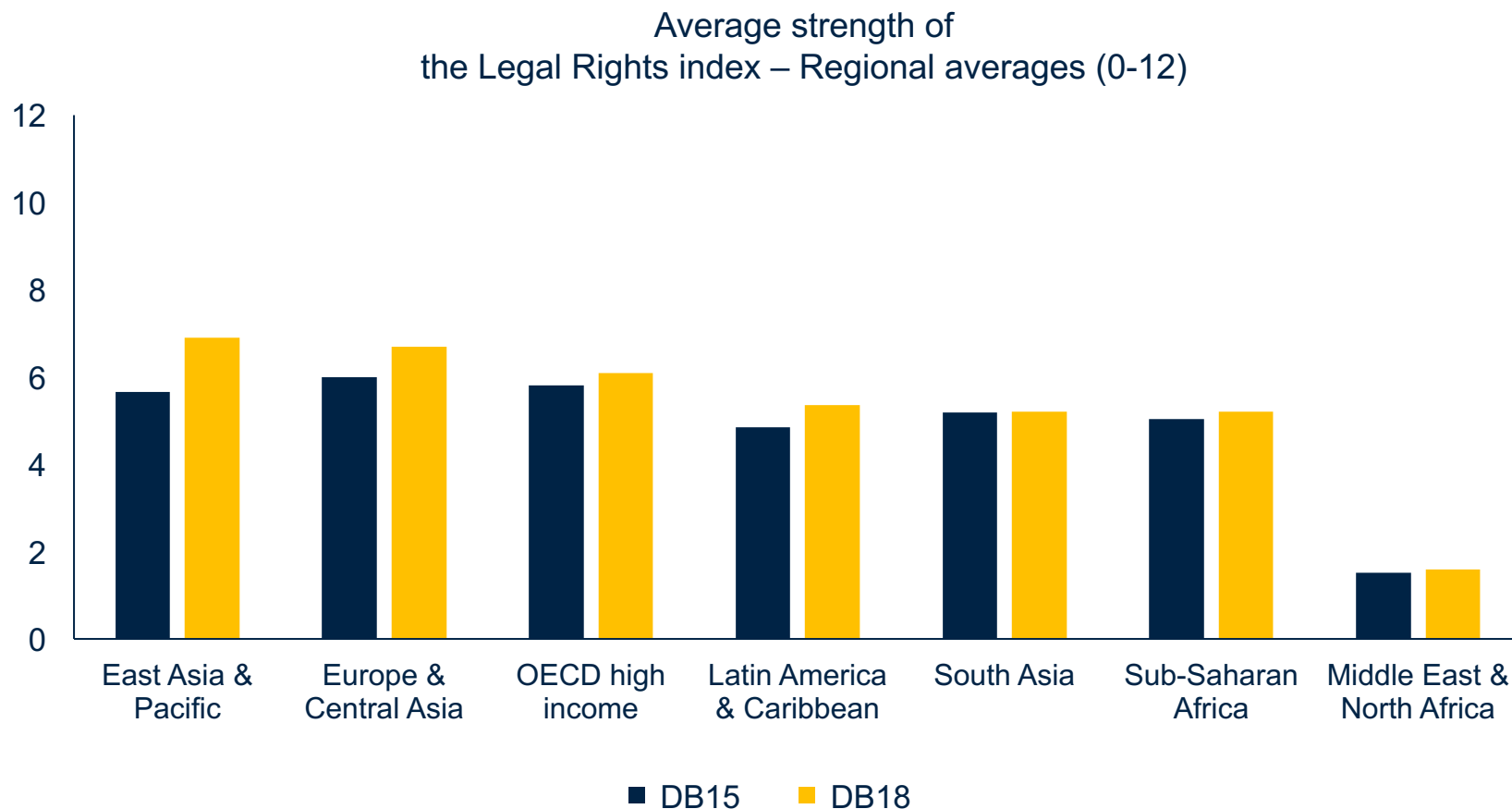
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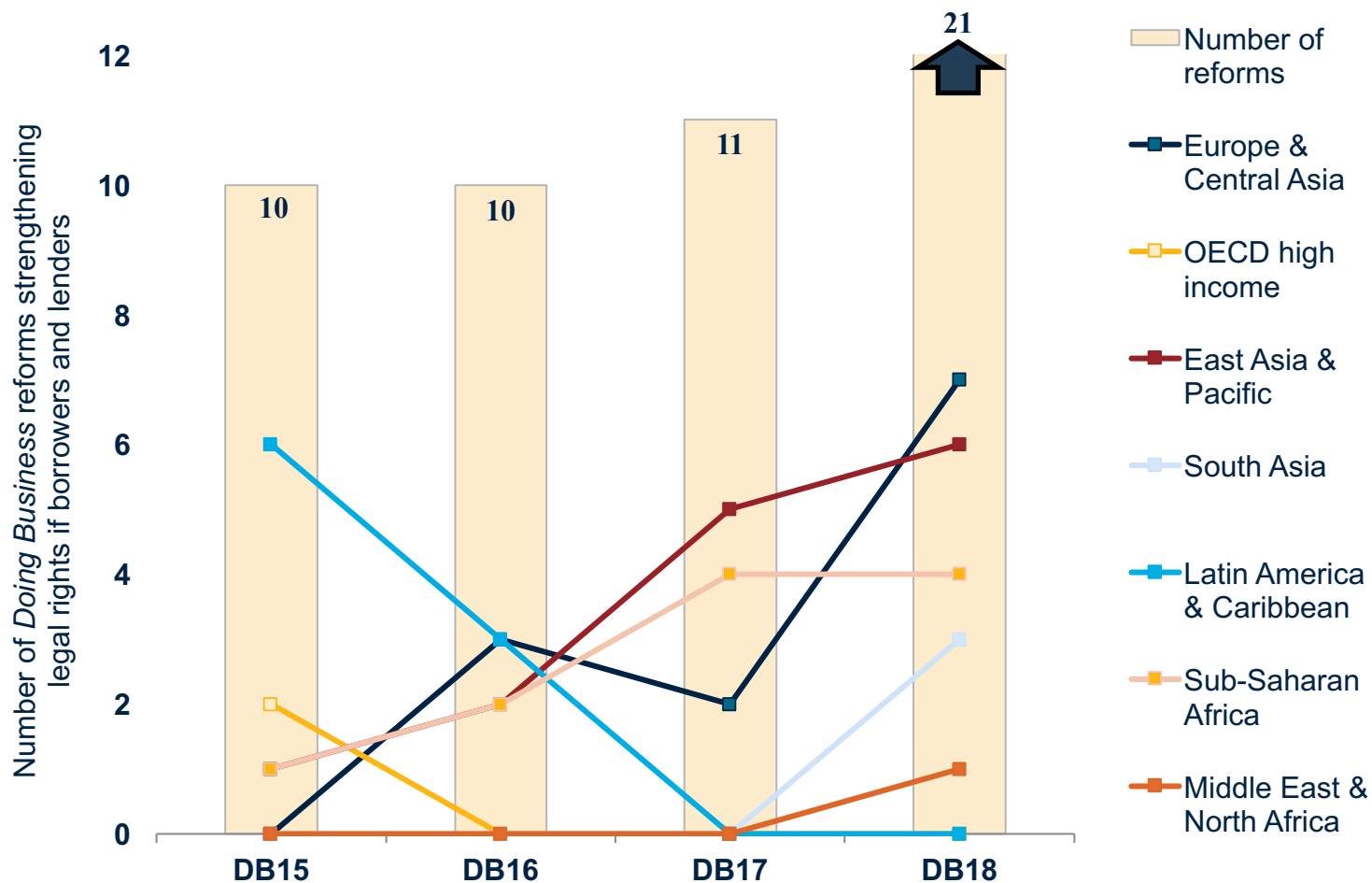


Legal rights index in *Doing Business* 2015 and *Doing Business* 2018



Source: *Doing Business* database.

Historical trends: Getting Credit – Legal Rights



Source: Doing Business database.

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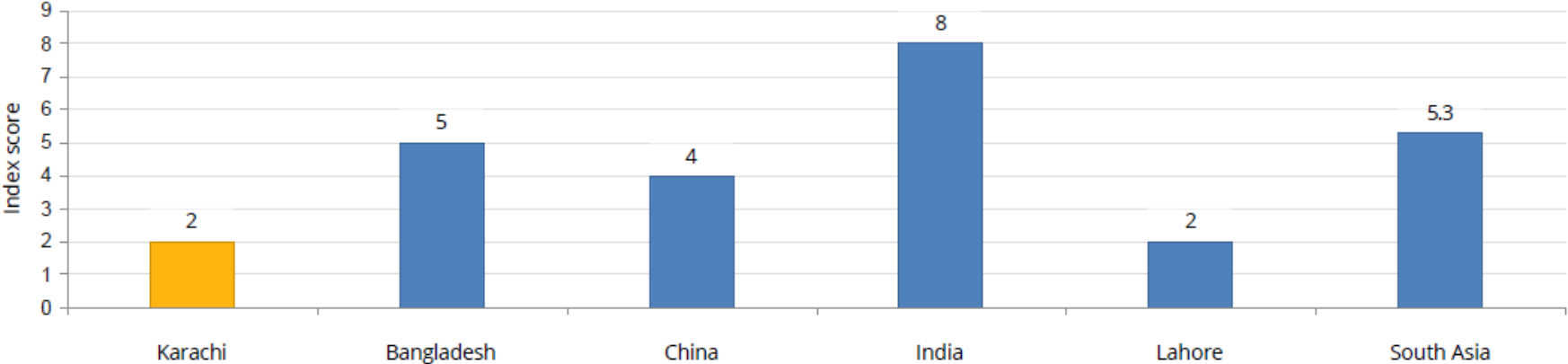
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Legal Rights results in Pakistan

Strength of legal rights index (0-12)	2
Does an integrated or unified legal framework for secured transactions that extends to the creation, publicity and enforcement of functional equivalents to security interests in movable assets exist in the economy?	No
Does the law allow businesses to grant a non possessory security right in a single category of movable assets, without requiring a specific description of collateral?	Yes
Does the law allow businesses to grant a non possessory security right in substantially all of its assets, without requiring a specific description of collateral?	Yes
May a security right extend to future or after-acquired assets, and does it extend automatically to the products, proceeds and replacements of the original assets?	No
Is a general description of debts and obligations permitted in collateral agreements; can all types of debts and obligations be secured between parties; and can the collateral agreement include a maximum amount for which the assets are encumbered?	No
Is a collateral registry in operation for both incorporated and non-incorporated entities, that is unified geographically and by asset type, with an electronic database indexed by debtor's name?	No
Does a notice-based collateral registry exist in which all functional equivalents can be registered?	No
Does a modern collateral registry exist in which registrations, amendments, cancellations and searches can be performed online by any interested third party?	No
Are secured creditors paid first (i.e. before tax claims and employee claims) when a debtor defaults outside an insolvency procedure?	No
Are secured creditors paid first (i.e. before tax claims and employee claims) when a business is liquidated?	No
Are secured creditors subject to an automatic stay on enforcement when a debtor enters a court-supervised reorganization procedure? Does the law protect secured creditors' rights by providing clear grounds for relief from the stay and sets a time limit for it?	No
Does the law allow parties to agree on out of court enforcement at the time a security interest is created? Does the law allow the secured creditor to sell the collateral through public auction or private tender, as well as, for the secured creditor to keep the asset in satisfaction of the debt?	No

Legal Rights in Pakistan and comparator economies



Rankings on Doing Business topics - Pakistan



THANK YOU!

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