Experiences in the use of unconventional guarantees as support for credit operations

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INTRODUCTION

• Research document forms part of CIDRE (non-bank development financial institution – IFD) pilot project in the INNOVATE portfolio
  o Aim to better understand, document and compare experiences of policies, use and effects of non-conventional guarantees for agricultural finance
  o This information will help CIDRE in working with the government of Bolivia to improve its policies
  o It also informs other countries on the potential use of non-conventional guarantees and what is important
  o The research is not globally comprehensive but focuses on a sufficient array of experiences to extract general learning for other countries
• Review of non-conventional collateral and collateral registries
  o 7 countries reviewed; 22 moveable collateral registries identified
  o All were preceded by legal reforms establishing the legal framework
• Success factors from movable collateral registries
• Yet, in spite of evidence, only four countries of those studied comply with the recommended factors for success

**Variable** | **Impact of Registry**
---|---
Access to financial services | 8% increase
Access to credit | 7% increase
Percent of working capital financed by banking entities | 10% increase
Interest rates | 3% decrease
Loan terms | 6-month increase
Empirical evidence supports the positive effect that collateral registration has on non-conventional guarantees, as well as the effects that financial instruments using this type of collateral, has on financial inclusion.

- There is a direct impact that this type of initiative has on interest rates, loan terms and access to formal credit.

The legal framework plays an important role in promoting positive results.

Use of unconventional guarantees in the Bolivian financial system is still incipient; there is still work to be done, both on the side of the legal framework and on the implementation of the collateral registration system and associated processes.
RELEVANCE OF THE LITERATURE REVIEW AND TOPIC OF NON-CONVENTIONAL COLLATERAL

• Literature review is relevant in documenting the benefits of collateral registries for non-conventional collateral

• It provides an overview of the experience in other countries

• It documents that Development Finance Institutions (DFIs) vastly lead in the use of non-conventional collateral

• The documented research is relevant beyond Bolivia to international development finance agencies (e.g. World Bank, IDB) and central banks in other countries
many countries do not have adequate, or some cases any moveable collateral registries; developing these can spur financial inclusion as these facilitate increased non-conventional lending.

- Microfinance has contributed heavily to development of non-conventional collateral policies and procedures; this experience can be leveraged to development the needed interventions for agricultural finance.
OTHER INTERESTING OR SIGNIFICANT POINTS

• Development financial institutions (DFIs) lead the use of unconventional guarantees in the Bolivian financial industry:
  
  o After participating in 74% of the national portfolio granted under unconventional guarantees
  o In June 2018 this participation was reduced to 44%, percentage reached after a gradual reduction started in August 2017 (64%).

• Mortgage guarantees are those that have the highest participation, which has historically fluctuated between 58% and 51%.

• Between 15% and 23% of the Bolivian loan portfolio has been guaranteed with moveable collateral
Main Features a Modern Collateral Registration System Should Have

- Unique source of centralized data for mobile assets and transactions backed with this type of assets (loans, leasing, warrants, withheld titles, among others), for a single jurisdiction.
- Record of transactions by all creditors and individuals.
- Registries must be associated with a unique identifier of the debtor, a registration number and a serial or identification number of the asset or collateral registered.
- The registry must not exclude any type of mobile asset.
- Online registration platform, available 24/7.
- Registration must be based on notifications and not require the sending of information.
- Inscription in the registry is made by the creditors or their formal representatives (there is no need for intermediaries).
- Public searches are allowed without restrictions, and without variation.
- Simple and basic payments are used to finance the costs of registry operations. Consultations; free or low-cost consultations are allowed.
- Adequate infrastructure provides a sufficient information security scheme.
- Flexibility in payment methods is offered.
SUCCESS FACTORS IDENTIFIED - LEGAL FRAMEWORK

- Offering a wide spectrum of accepted and permitted collateral
- Ease of creation and registration of collateral
- Centralized management system for pledged assets
- Clear rules for prioritization for the awarding of collateral rights during liquidation
- Application and effective execution of the standard, which facilitates the process of awarding and realizing collateral
- Allows non-possessory promises (without assignment of asset ownership) as collateral to secure loans and / or support other financial assets
- Standardization of processes and requirements for the registration of assets
- Establishment of efficient property registries with clearly defined responsibilities and which are accessible to the public
MAIN FUNCTIONS OF COLLATERAL

**Be transformative**
- Mitigate credit risk
- Change the function of an asset to make financing viable

**Be informative**
- Signal the credit status of a borrower
- Signal weaknesses or negotiation risk
- Facilitate the substitution of credit

**Provide incentives**
- Effect the costs and information on credit creation
- Provide known risks to financiers
- Encourage borrowers to comply with contracts
BOLIVIAN LAW 393 DEFINES NON-CONVENTIONAL GUARANTEES (21 AUGUST, 2013)

a) Guarantee funds
b) Agricultural insurance
c) Documents in custody of property of real estate and rural properties
d) Assets not subject to property records
e) Contracts or commitment documents for future sales
f) Guarantees or certifications from community organizations or territorial organizations
g) Stored products
h) Livestock
i) Intellectual property patents
j) Other alternatives of unconventional guarantees, subject to approval by ASFI (Financial System Supervisory Authority).
The non-conventional guarantees most used are documents held in deposit (84%).

The registry of non-property assets was only 4% but is increasing:
  - IFDs (e.g. CIDRE) account for approximately 2/3 of the non-conventional guarantees
  - Banks and credit unions are starting to increase their use of them

Even though the Bolivian Law 393 recognizes non-conventional guarantees and is quite comprehensive, there is need for a more integral link within the financial system to facilitate adoption.