

THE NEW SECURITY INTEREST SYSTEM IN COSTA RICA: SOME RELEVANT DATA

Joaquín Picado-González*

TABLE OF CONTENTS

| | |
|---|-----|
| I. INTRODUCTION | 139 |
| II. CURRENT SITUATION | 141 |
| III. REFORM OF THE LEGAL SYSTEM AND ITS IMPLICATIONS | 142 |
| A. Evolution from the Pledge Concept to the Security Interest Concept | 142 |
| B. Use of Any Property as an Object of Security Interest (<i>Numerus Apertus</i>) | 143 |
| C. Opening of the Possibility of Providing a Security by the Legal Holder Although it is not the Owner Thereof | 143 |
| D. Development and Implementation of Expedited Enforcement Procedures | 144 |
| E. Modernization of Secured Interests' Registry System | 144 |
| F. Interdependence Between the Secured Transactions Law and the Bodies Regulating Banking and Financial Functions | 145 |
| IV. CONCLUSION | 145 |

I. INTRODUCTION

In Latin America, limited access to credit for the most vulnerable social sectors has been a constant concern. Governments have addressed the problem from many angles, seeking to find practical solutions that are durable and efficient.¹ Special credit programs have been promoted for micro-, small-, and

* Founding member of Signature Regional Law Group and Picado & León Abogados. Professor of the Universidad Escuela Libre de Derecho de Costa Rica. International consultant on Security Interests for the National law Center for Inter-American Free Trade; United States Department of the Treasury Office of Technical Assistance (OTA); International Law Department of the Organization of American States (OAS).

¹ See generally *Servicios financieros para el desarrollo: promoviendo el acceso en América Latina Serie: Reporte e Economía y Desarrollo* [Financial Services for Development: Promoting Access in Latin America], CORPORACIÓN ANDINA DE FOMENTO (April 2011), <http://www.caf.com/media/3895/RED2011.pdf>; Liliana Rojas-Suárez, *El Acceso a los Servicios Bancarios en América Latina: Identificación de Obstáculos y Recomendaciones* [Access to Banking Services in Latin America], CENTER FOR GLOBAL DEVELOPMENT (June 2006), http://www.cgdev.org/doc/experts/Serv_Bancarios_AL.pdf;

medium-sized enterprises (MSMEs), either through the creation of “banks or credit financial institutions for development,”² or through the creation of special credit programs, among many others. In Latin America, the primary objective of all these solutions is to design credit policies with requirements, conditions, and guarantees that are different from the traditional ones to facilitate looser credit policies, which allow MSMEs to take advantage of the benefits of the formal financial system and to get better conditions than the ones to which they traditionally had access.³

Besides funding, all of these programs require a sound and clear regulatory framework that establishes a radical change in analysis and payment enforcement of commercial loans and the introduction of credit with nontraditional conditions. It requires, therefore, providing the MSMEs with new credit access conditions that result from implementing a transparent and balanced framework. This balance can only be achieved with the promulgation of clear legal regulation. Such regulation must also regulate the rights and obligations of the parties and ensure that basic principles of good bargaining faith are the ruling principles of the contractual behavior among the parties. Consequently, this balance can only be achieved where the rights of debtors and secured creditors are specified against one another and third parties, such as buyers of assets. This framework should be designed to facilitate lending operations resulting from a fair and equitable negotiation. That would allow for the application and development of best practices in structuring loans and enforcing security interests, which minimizes the potential for abusive conduct by any party.

The implementation of the Security Interest System in Latin American countries broke paradigms and enabled change that so overcame ‘alleged basic formal principles’ as to make those principles irrelevant under the new legal and commercial rules. Such changes include the prohibition of the forfeiture clause; the introduction of expedited enforcement procedures, whether judicial or extrajudicial; eliminating unnecessary formalities such as the rigidity of the notarization requirements; and the introduction of electronic notice-filing registries to replace folio real entries, which at present, only apply to some security interests in movable property.

Costa Rica has been no exception to the rule. Urging for greater economic development and opening credit for the MSMEs sector, it has begun changes to implement a regulatory framework for security interests, especially in traditionally forgotten sectors. In my opinion this country has committed to a

Muriel Zuñiga, *Acceso al crédito de las mujeres en América Latina* [Access to Credit for Women in Latin America], COMISIÓN ECONÓMICA PARA AMÉRICA LATINA Y EL CARIBE (March 2004), http://www.eclac.cl/mujer/proyectos/gtz/publicaciones/word_doc/Muriel_Zuniga.pdf.

² *E.g.*, Licitacion 8634,87 LA GACETA-DIARIO OFICIAL [LA GAC.-D.O.] [OFFICIAL GAZETTE OF COSTA RICA], 7 de Mayo de 2008 (Costa Rica).

³ For example, in Latin America, financial institutions require no traditional guarantees in the MSME sector. So, MSMEs are forced to seek informal credit with usurious interest rates ranging from 50% to 400% annually.

system that allows for the development of credit with the participation of private and public companies, that uses the participation of a free and equal financial market to materialize solutions that previously relied on the political will and state resources, and that relies on clear and transparent rules as a guiding principle.

This article summarizes the current situation of Costa Rica, specifically the degree of progress in implementing the new system. In addition, the article especially mentions the following:

- (1) The reform of the legal system and its implications;
- (2) The analysis of the “pledge” concept evolution;
- (3) The application of the concept of *numerous apertus* to security interests and the changes in parties permitted to provide an asset as collateral;
- (4) The eminent need for creating expeditious enforcement procedures; and
- (5) The necessary changes in the registry systems.

The article reflects on the role of regulating bodies and finally considers the implications of the changes in Costa Rica.

II. CURRENT SITUATION

Costa Rica began its reform process under the leadership of the Ministry of Industry and Trade with support from International Finance Corporation (IFC)⁴ and the National Law Center for Inter-American Free Trade (NatLaw).⁵ Using these resources, it achieved the adoption of the Secured Transactions Law in 2014.⁶ Inspired by NatLaw’s *12 Principles of Secured Transactions Law in the Americas*,⁷ the OAS Model Law,⁸ and UNICITRAL’s Legislative Guide on Secured Transactions,⁹ it is a clear and highly impactful regulation on the Central

⁴ INTERNATIONAL FINANCE CORPORATION, <http://www.ifc.org> (last updated Aug. 9, 2015).

⁵ NATIONAL LAW CENTER FOR INTERAMERICAN FREE-TRADE, <http://www.natlaw.com> (last visited Aug. 9, 2015).

⁶ Licitacion 9246,95 LA GACETA-DIARIO OFICIAL [LA GAC.-D.O.] [OFFICIAL GAZETTE OF COSTA RICA], 20 de Mayo del 2014 (Costa Rica), http://www.gaceta.go.cr/pub/2014/05/20/ALCA17_20_05_2014.pdf [hereinafter Secured Transactions Law].

⁷ See *NLCIFT 12 Principles of Secured Transactions*, NAT’L L. CTR. FOR INTER-AM. FREE TRADE, <http://www.NatLaw.com/content/nlcift-12-principles-secured-transactions> (last visited Jan. 15, 2015).

⁸ SECRETARIAT FOR LEGAL AFFAIRS, ORGANIZATION OF AMERICAN STATES, MODEL INTER-AMERICAN LAW ON SECURED TRANSACTIONS, http://www.oas.org/en/sla/dil/docs/secured_transactions_BOOK_Model_Law.pdf (2002).

⁹ UNICITRAL, *Legislative Guide on Secured Transactions* (2010), https://www.uncitral.org/pdf/english/texts/security-1g/e/09-82670_Ebook-Guide_09-04-10English.pdf.

American market of security interests. Financial, legal, and MSME sectors all found this reform important. In addition, several relevant fora have mentioned it, which can positively impact the credit market in this area.¹⁰ Law 9246,95 came into force on May 25, 2015. Its Security Interest System is fully electronic.¹¹

III. REFORM OF THE LEGAL SYSTEM AND ITS IMPLICATIONS

A. Evolution from the Pledge Concept to the Security Interest Concept

The legal reform based on the evolution of the pledge concept has been one of the hardest fights in Costa Rica. Most Latin American jurists believe that the immobilization of personal property assets improves the quality of collateral. If the personal property asset is isolated, then the creditor has more opportunities to recover the credit's capital. The pledge in Latin American countries is known as a very solid collateral, comparable to a mortgage in a real estate transaction. As a result, the pledge has many formalities and in most cases needs to comply with notarization. In the pledge, it is necessary to provide an exact description of the collateral for its record in the Pledge Register.¹² In contrast, the Secured Transactions Law introduces the Security Interest System as a new way to use the mobile asset.¹³ The debtor has the right to use, change, and sell the collateral to produce profit to pay the credit capital. It does not require notarization and the register system is very simple.

The introduction of a dynamic system and the principles of voluntary enforcement of the collateral as a form of payment have generated some resistance. Fortunately, when operators visualize the benefits of the new system and realize that the system strengthens rather than weakens collateral, their resistance fades.

Costa Rica failed to overcome this point without setting exclusions to the system. Unfortunately, as a product of political negotiations between the government and the registrars' union, a mixed system was adopted wherein the pledge survived for vehicles that have a mandatory registration in the Registry of Vehicles.¹⁴ The Security Interest System will govern all other movable property. Thus, the government at least managed to open the Security Interest System for important goods like agricultural equipment and industrial machinery. Several jurists at symposia expressed discomfort over this situation, but the truth is that

¹⁰ We refer to the two symposiums of security interests organized by Costa Rica Bar Association, as well as several conferences organized by the Superintendent of Financial Institutions and the Ministry of Economy, Industry and Trade.

¹¹ See REGISTRO NACIONAL, <https://sgam.rnp.go.cr/> (last visited Aug. 9, 2015).

¹² *Id.*

¹³ Secured Transactions Law, *supra* note 6.

¹⁴ Secured Transactions Law, *supra* note 6, art. 3 (excluding automobiles, buses, and loading vehicles as source of collateral).

Costa Rica currently has two legal systems working simultaneously that should ultimately consolidate into one Security Interest System.

B. Use of Any Property as an Object of Security Interest (*Numerus Apertus*)

The Costa Rican law has incorporated the legal capacity to use any movable property as security for loan operations.¹⁵ The immediate reaction of lawyers and operators of these markets has been to say that security interests do not introduce anything new to the system because in the pledge system it was possible to encumber personal property without restriction.¹⁶ This assertion is not entirely correct. Despite the use of the pledge in practice, the amount of movable property used as security was very limited because of the excessive formalism and rigidity of the pledge, which created enforcement problems based on misidentification of the security, the excessive cost of the procedure, and the impossibility to use a security interest on the part of different creditors. Though, the latter had a lower degree of priority for non-payment of the obligations. Under the country's new Security Interest Systems, creditors gain a larger selection of securities within a simple, unitary, and transparent legal framework that allows the use of movable property as security without the excessive formalities.¹⁷ Consequently, systems allow financial entities to use new security interests that were unthinkable before, like the profits from sales of computer programs or from the extraction of resources awarded by the government. They also allow the use of security interests that were already being used and extra-legally, such as control agreements between financial institutions and their clients.

C. Opening of the Possibility of Providing a Security by the Legal Holder Although it is not the Owner Thereof

Following the opening of the use of various security interests, there was a radical change within the Costa Rican legal system. The change allows the "legal owner" of the movable property to create the security interest without necessarily being its owner.¹⁸ Currently, the principle of movable property that possession is equivalent to legal title is excessive. Therefore, a legal holder may offer a security without proving ownership of the good he possesses. However, this rule does not apply to movable property when the ownership determination depends on traceability originating in a special register. In that case, the law is clear in stating

¹⁵ *Id.*

¹⁶ *See, e.g.*, Código de Comercio [C. Com.] [Commercial Code] art. 530 (Costa Rica) (declaring "the pledge contract will serve to secure all kinds of obligations subject to the rules of the following articles, except for loans made by pawnshops as well as bonded warehouses, which are governed by special provisions.").

¹⁷ Secured Transactions Law, *supra* note 6.

¹⁸ Secured Transactions Law, *supra* note 6, arts. 7-8.

that possession of such movable property is insufficient and those seeking to collateralize the property must prove that they own the property.

This change allows the new Security Interest Systems to use movable property as security, which was unthinkable before. For example, the natural resources that can be exploited through a concession can be used by the licensee in two ways: (1) creating a security interest on an intangible right, i.e., the concession; or (2) over the results of exploiting the concession—minerals (tangible rights)—where the licensee of the concession is not the owner of the natural resources.

D. Development and Implementation of Expedited Enforcement Procedures

The subject of expeditious enforcement associated with extrajudicial enforcement has caused a continuing controversy in all Latin American countries whose regulatory bodies are inspired by systems in the Roman-Germanic tradition. Little by little, we have changed the belief that the only way to ensure a “constitutional due process” is through a supervised enforcement by the courts. In Costa Rica, this fight to allow alternative means of dispute resolution has been overcome largely because of the discussion that took place while delving into the regulation of arbitration, mediation, and conciliation. In addition, the issue was discussed when the legality of the private fiduciary enforcement in cases of guarantee trusts was questioned.

With the Secured Transactions Law, two possibilities of enforcement are introduced: (1) the traditional way, namely, through the courts; or (2) extrajudicial procedures through processes of the parties’ design that depend on the type of personal property at issue.¹⁹ This extrajudicial process allows the parties to use private executors and expedite procedure, as described in Article 57 of the law.²⁰ Established in the Law, this process allows for execution without the presence of the judge, by means of public notary, administrative sworn brokers, or the trustee. Thus, it complies with due process in a shorter period of time.

E. Modernization of Secured Interests’ Registry System

The change from traditional registration based on registry entries and ownership to a registration or information system wherein the security interest may not necessarily exist at the time of registration was hotly debated in Costa Rica.²¹ Those opposed argued that it is not possible to conceive of a registration without qualification and give the option to the creditor to enter the information

¹⁹ Secured Transactions Law, *supra* note 6.

²⁰ *Id.* art. 57.

²¹ Dra. Ligia Roxana Sanchez-Boza, Comment to *Simposio Internacional sobre la Nueva Ley de Garantías Mobiliarias* (Aug. 29, 2014), COLEGIO DE ABOGADOS Y ABOGADAS DE COSTA RICA, <https://www.youtube.com/watch?v=6svSVWmUPrk>.

into the system by a creditor or an authorized third party. They argued that a new registration system would generate legal uncertainty and rampant fraud. Despite the opposition, the Costa Rican law incorporated a fully electronic system where, in real-time over the Internet, parties can make queries, registrations, modifications, cancellations, and request certifications of registrations, using a unitary and centralized system.²² The registry system has been adjusted to international standards. And it is inexpensive. The maximum cost does not exceed \$11 USD, which has allowed the addition of more than 1,000 entries in two months of operation.²³ The Security Interest System, as it has been called in Costa Rica, is being handled by the Public Registry—a State institution—in charge of all public records, internationally recognized for its efficiency.

F. Interdependence Between the Secured Transactions Law and the Bodies Regulating Banking and Financial Functions

The regulators of banking and financial functions should be aware that this type of credit cannot have the same supervisory requirements as the ones existing for credits having real property as security. The operation of the system will depend on placing regulators in a position for change and financier assimilation of that change.

In Costa Rica, the superintendence of financial institutions has publicly admitted,²⁴ that it is seriously working on the necessary adjustments for financial institutions to use the aforementioned movable property and that such property may be used as risk mitigation within the loan portfolio reports of supervised financial institutions because internal regulations excluded at the time some of the personal property that the law now permits. With this change, the training of the financial sector becomes necessary to enable the use of this security in all possible dimensions.

IV. CONCLUSION

For Costa Rica, the adoption of a Security Interest System has involved a paradigm shift within the legal system and a breach of traditional Roman-Germanic principles. This change generated much controversy that has slowly weakened as people begin to see, work, and operate in the new system of security interests. The change was not only legal. It led to the adoption of a new way of doing business. The scope of use of movable property has been extended and

²² REGISTRO NACIONAL, *supra* note 11.

²³ *Id.*

²⁴ Genaro Segura Calderón, Dir., Rules and Regulations of the Superintendence of Fin. Entities, *Costa Rica II Simposio Sobre Garantías Mobiliarias: Implementación y Desafíos* (July 20, 2015).

financial entities have come to understand that business opportunities have increased.

For MSMEs, the direct benefits are unquestionable because many companies that were not considered creditworthy because their assets could not serve as collateral for financiers, now have the opportunity to create and access revolving credit lines, giving as collateral contract flows or future sales contracts and present or future tangible or intangible personal property.

Costa Rica was courageous to seek a solution to the problem of credit access. The Secured Transactions Law is a tool, which, if well used, can be very helpful in strengthening the countries with emerging economies. Costa Rica has great expectation in its success.

