

# WHITE PAPER

The Enforcement of Securities  
in the Lao PDR

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## **The Enforcement of Security in the Lao PDR**

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## INTRODUCTION

In the Lao PDR, 99% of enterprises are small and medium enterprises (“**SMEs**”). Notably, these SMEs employ over 80 percent of the country’s workforce<sup>1</sup>. However, as per a survey undertaken by the Bank of the Lao PDR (“**BOL**”) in 2017, only about 20 percent of these SMEs are able to access loans from banks and financial institutions<sup>2</sup>. Per the World Bank Group’s 2020 *Ease of Doing Business*, the Lao PDR was ranked 80 out of 190 economies in access to credit<sup>3</sup>, a decline from its previous ranking of 73 in 2019.

The efficiency of a country’s secured transaction legislation is one of the key elements that influence the ease of businesses’ access to credit, as a creditor strongly relies on the degree of ease in creating, perfecting, and enforcing its security rights when assessing the risk in granting a long-term loan. The enactment of the Law on Enterprise Rehabilitation and Bankruptcy (No. 75/NA, 26 December 2019) (the “**2019 Insolvency Law**”) and the establishment of the central registry for online registration of security interests over movable assets are laudable efforts on the part of the Government of the Lao PDR (“**GOL**”), and have improved the ease of creation and registration of security interests to a certain extent. However, the overall efficiency of the secured transactions legal framework is still lacking, particularly the procedure for the enforcement of security interests. We conducted a general survey of banks and non-banking financial institutions (hereafter, collectively referred to as the “**finance sector participants**”) and in general, they consider the current procedure for the enforcement of security lengthy, unclear, and cumbersome.

Although the GOL has formulated an action plan to improve the ease of doing business in the Lao PDR through policy reforms<sup>4</sup>, the action plan does not address the issues concerning creation, perfection, and enforcement of secured transactions in the Lao PDR.

This white paper prepared by the European Chambers of Commerce and Industry in Laos (ECCIL), aims to draw the attention of the GOL to the existing regulatory uncertainties and the practical issues concerning the enforcement of securities in the Lao PDR.

## DESCRIPTION OF THE ISSUES AND RECOMMENDATIONS

This white paper prepared by the European Chambers of Commerce and Industry in Laos (ECCIL), aims to draw the attention of the GOL to the existing regulatory uncertainties and the practical issues concerning the enforcement of securities in the Lao PDR.

The Civil Code No. 55/NA dated 6 December 2018 (the “**Civil Code**”) came into effect on 26 May 2020, which among other laws and regulations, covers the legislative framework for secured transactions. Pursuant to the enactment, Part VII of the Civil Code has replaced a majority of the provisions of the Secured Transaction Law No. 06/NA dated 20 May 2005 (the “**Secured Transaction Law**”). The provisions of the Secured Transaction Law were implemented in accordance with the provisions of the Decree on the Implementation of the Law on Secured Transactions No. 178/PM dated 20 June 2011 (the “**Implementation Decree**”). Although the enactment of the Civil Code is a step in the right direction, it is by no means a comprehensive legislation that adequately deals with all aspects that a modern secured transaction law is expected to cover, such as a comprehensive procedural framework for the enforcement of secured transactions. Below are some key issues concerning the enforcement of securities in the Lao PDR.

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<sup>1</sup> The World Bank, “Maintaining Economic Stability in Lao PDR,” 12 August 2019. Accessed at <https://www.worldbank.org/en/country/lao/publication/maintaining-economic-stability-in-lao-pdr>.

<sup>2</sup> The World Bank, “Unlocking Access to Finance for Small and Medium Enterprises in Lao PDR,” 18 September 2020. Accessed at <https://www.worldbank.org/en/news/feature/2020/09/18/unlocking-access-to-finance-for-small-and-medium-enterprises-in-lao-pdr>.

<sup>3</sup> The World Bank, *Doing Business 2020 (Lao PDR)*. Accessed at <https://www.doingbusiness.org/content/dam/doingBusiness/country/l/lao-pdr/LAO.pdf>.

<sup>4</sup> Investment Promotion Department, the Ministry of Planning and Investment of the Lao PDR, “Doing Business Reforms in Laos Action Plan 2020 – 2022”, July 2020. Accessed at <https://eccil.org/news/doing-business-reforms-in-laos-action-plan-2020-2022/>

# ISSUE 1

## Unclear procedural rules for the enforcement of security by a secured creditor

We have subdivided the above issues as follows:

1. No standards or guidelines for assessing the market value of collateral; and
2. Ambiguity regarding the procedure for a creditor to take possession of a secured asset during the enforcement of security.

### **No standards or guidelines for assessing the market value of collateral**

One of the issues that often causes a lot of uncertainty and dispute is the disagreement between the creditor and the borrower regarding the valuation of a secured asset. The Civil Code requires that the sale or auction of a secured asset must be done on the basis of the market value of the asset as at the time of enforcement, unless the borrower has agreed otherwise in writing. However, the Civil Code does not provide any mechanism for assessing such market value. Per the finance sector participants, the borrowers/security grantors usually abuse their right by challenging the valuation of a secured asset, which not only delays the enforcement procedure but also increases the secured creditor's costs.

### **Recommendation**

It is recommended that the GOL develop a framework outlining the methodology for assessing the price of a secured asset by the secured creditor on the basis of certain generally accepted principles and practices so that such valuation cannot be disputed by the debtor or security grantor during enforcement proceedings.

Further, it is highly recommended that the GOL establish an institutional framework for the training and certification of qualified professionals as experts in assessing the market value of secured assets on the basis of the standards mentioned in the above paragraph. This could be an effective solution as it will make the valuation of the secured assets standardized, regulated, and reliable, thus enhancing the efficiency of the existing security enforcement mechanism.

It is envisioned that this could be similar to the recently developed framework for the registration of custodians of assets in the enforcement of insolvency proceedings as provided under Part III of the Insolvency Law.

### **Ambiguity regarding the procedure for a creditor to take possession of a secured asset during the enforcement of security**

The new Civil Code allows creditors to create security over an asset without taking possession of the asset by simply registering their security interest with the registration authority. In such cases, if a security grantor defaults and the creditor elects to enforce its security interest, the creditor will need to take possession of the asset before it can auction the asset or privately sell it to a third party. However, the Civil Code is silent on how and when such a secured creditor can take possession of the asset prior to disposing of it. It is an important issue, as the secured creditor must be entitled to take possession of the asset before it can conduct a sale or auction.

## Recommendation

A majority of the finance sector participants are of the opinion that the above issue is only part of the bigger issue – the lack of clear procedural rules for the enforcement of security. Therefore, we recommend that a comprehensive implementation decree be enacted that contains all essential rules for the enforcement of a security interest, including rules for the assessment of market value, transfer of a security interest to a third party, service of notice, and taking possession of the secured asset, to replace the current Implementation Decree. The implementation decree should form the basis for both the voluntary enforcement of securities and the judicial enforcement of securities so that the whole enforcement process is clear, unambiguous, and efficient.

The GOL may refer to Chapter VII (Enforcement of Security Rights) of the UNCITRAL Model Law on Secured Transactions: Guide to Enactment and Part II, Section I (How to Enforce a Security Right) of the UNCITRAL Practical Guide to Model Law on Secured Transactions for guidance on international best practices to develop an efficient implementation decree that addresses the above issues.

## ISSUE 2

### **Inconsistency in relation to the priority ranking of security interest types**

According to Article 46 (Division of Money received from the Decision and Transfer of Ownership) of the Implementation Decree, the amount collected from the disposal of secured assets must be distributed among the affected parties in the following order:

- Reasonable expenses incurred by a secured creditor for enforcement of the security interest, including costs for taking possession and making any improvement or repair of the collateral, legal expenses, etc.;
- Obligations subject to the laws;
- Payment of obligations based upon the sequence of preferential rights.

This means, in the case of an enforcement proceeding, the obligations that the grantor owes to the state must be paid first before the secured creditors can be paid. The position that the finance sector participants are most worried about is the dilution of the priority of their security interests due to the automatic preferential right of the state, because it not only reduces the value of the secured asset but also renders the creation and perfection of security interest over the asset worthless.

A remedy is only as good as the implementation of that remedy permits it to be. If the value of a secured asset upon enforcement is expected to be only a fraction of its market value, then a creditor usually demands multiple assets to be given as security, which means the terms of getting credit are less favorable to the debtors and often puts an added burden on them, the majority of which are SMEs or family businesses that are not in a position to provide high-value collateral.

Further, the aforesaid Article 46 of the Implementation Decree is inconsistent with Article 84 of the 2019 Insolvency Law, which entitles secured creditors to be paid from the liquidation proceeds prior to the payment of the outstanding GOL obligations in the case of insolvency.

### **Recommendation**

It is recommended that the order of distribution of proceeds in the case of an enforcement of security be made consistent with the provisions of the Insolvency Law so that the interests of secured creditors takes priority over state debts and obligations.

## ISSUE 3

### Lengthy and uncertain judicial process

In general, the finance sector participants in the Lao PDR consider the current judicial enforcement procedure to be lengthy and uncertain. As per the finance sector participants, the voluntary enforcement of security is often challenged by debtors and therefore, secured creditors have to go to court to seek judicial enforcement or defend their rights against debtors. In this context, it is essential to highlight that **the current judicial process is slow and the decision making is inconsistent, which adversely affects the efficiency of the enforcement proceedings.**

A significant expansion of commercial plantations of 200,000 ha in Lao PDR would attract a notional investment of USD 440 – 500 million for the plantations alone, depending on negotiated land costs, requirements for clearance of unexploded ordnance (UXO), roading and contingencies. The creation of wood processing industries expands this investment even further: recent investments in plywood mills and veneer mills of USD 15 – 20 million and integrated pulp/ recycled fibre/ packaging paper facilities of USD 1 billion provide indications of current and possible levels of investment.

As we know, the value of certain assets such as vehicles, electronic gadgets, and inventories depreciates over time. The judicial enforcement procedure should enable prompt realization of the secured assets at their market value. In the Lao PDR, it usually takes up to nine months on average for the court of first instance to decide a civil matter. Thereafter, it takes about 90 days or more to obtain a decision from an appellate court. If the final outcome of the expected judicial enforcement proceedings takes 12 months or more on average, then the creditor is likely to give credit on less favorable terms to a prospective borrower.

Generally speaking, one of the major factors that affects the efficiency of the courts and the duration of the judicial proceedings is the lack of adequate specialized training for judges to adjudicate matters related to a specific field of law, such as the secured transaction laws, or the financial transaction laws. The lack of training and experience means that judges have to spend more time to adjudicate a matter and are also more prone to making errors in decision making and interpretation due to a lack of a clear understanding of the legal principles.

Another important factor that contributes to the delay in the judicial procedure is the unavailability of case law of already adjudicated matters on the same types of issues. In our opinion, if judges have an opportunity to analyze previous court decisions on similar matters then they would be able to decide faster and more consistently on recurring issues. Each time a new case comes before a court of first instance, the judges have to deal with all of the issues involved by themselves from the beginning, which reduces the efficiency of the judicial proceedings.

Inconsistency in the judgments of Lao courts is another big issue that needs to be addressed at the earliest opportunity. Judicial enforcement decisions are not published and there is a lack of unified case law, which hinders the ability to apply precise standards when a court hears challenges to the enforcement of security from borrowers. This lack of clear procedures and uniform court practice means that decisions are made on a case-by-case basis and results in a lack of confidence among finance sector participants regarding how a specific issue will be handled by a Lao court.

A majority of the finance sector participants expressed concern regarding debtors regularly abusing their right to challenge an enforcement proceeding, which unnecessarily delays the court proceedings and frustrates the whole purpose of creating and perfecting security.

## Recommendations

- We recommend that the GOL make regulatory reforms to create specialization within the existing court system, i.e. specific judges should have specialized knowledge to adjudicate matters related to a specific field of law. For instance, the judges who are responsible for adjudicating matters in relation to financial transactions and insolvency should also handle enforcement proceedings exclusively, rather than another judge who has experience on general commercial matters but lacks specialized knowledge in relation to financial transaction legislation.
- The overall duration of judicial proceedings should be further shortened by the appellate courts and the Supreme Court of the Lao PDR via adoption of procedural rules for accelerated proceedings with prioritization of enforcement disputes.
- It is also recommended that specialized training and education be provided to those judges and judge candidates who are handling or going to handle matters related to secured transactions and insolvency legislation.
- In the opinion of the finance sector participants, which is shared by ECCIL, the unification of cases and providing public access to court decisions would help to prevent unfair or abusive judgments and further consolidate the efficiency of the judicial enforcement mechanism of the Lao PDR.

The finance sector participants strongly believe that the above reforms will help in strengthening the confidence of creditors in the Lao judicial system, which is a crucial factor for ensuring that creditors are comfortable in lending to SMEs and small businesses without having to stress or worry about the enforcement of their security interest. ECCIL also proposes that the GOL allow for the automatic transfer of court enforcement orders by the judgement creditor to a third party in the case of the transfer of a loan, without the requirement of prior approval from the court. In the opinion of ECCIL, this would increase the viability of extrajudicial enforcement of security as the new creditor would not have to get a new enforcement order from the court.

## CONCLUSIONS

We hope that this white paper provides the policy makers of the Lao PDR an insight into the practical issues and difficulties faced by businesses in effectively enforcing security in the Lao PDR. In addition to the issues highlighted in this white paper, we also support the business reforms recommended under the Policy Note on Registration of Credit Documentation and Loan Security Agreements dated 21 May 2019 prepared by the Business Working Group of the Lao National Chamber of Commerce and Industry, which has already highlighted some of the important issues that the finance sector participants face in relation to the creation and registration of security interests in the Lao PDR<sup>5</sup>.

The finance sector participants and ECCIL strongly believe that if the above issues are timely addressed by the policy makers of the Lao PDR, it will not only **increase the efficacy and efficiency of the secured transaction laws**, but also enhance SMEs' accessibility to credit and thus, **facilitate the ease of doing business in the Lao PDR**.

In regards to the above, we sincerely hope that our recommendations herein are considered by the GOL and that the GOL implements suitable reforms to strengthen the regulatory framework of the secured transaction laws in the Lao PDR. For the GOL's reference, we provide below the international soft laws and guidelines that collectively form the benchmark for the model secured transaction laws:

- (a) The EBRD Core Principles for a Secured Transactions Law;
- (b) The EBRD Model Law on Secured Transactions;
- (c) The UNCITRAL Legislative Guide on Secured Transactions;
- (d) The UNCITRAL Model Law on Secured Transactions;
- (e) The UNCITRAL Model Law on Secured Transactions Guide to Enactment;
- (f) The UNCITRAL Practice Guide to the Model Law on Secured Transactions; and
- (g) The World Bank Principles for Effective Insolvency and Debtor Creditor Regimes.

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<sup>5</sup> Accessed at <https://incci.la/wp-content/uploads/2019/08/1.-Policy-note-on-credit-and-security-registration.pdf>.





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