THE COSTS AND BENEFITS OF PERSONAL PROPERTY SECURITIES (PPS) REFORM

REPORT BY
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FOR

THE AUSTRALIAN ATTORNEY-GENERAL'S DEPARTMENT

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ACCESS ECONOMICS

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EXECUTIVE SUMMARY

The Australian Attorney-General's Department commissioned Access Economics to report on the potential costs and benefits of reform to the current arrangements dealing with personal property security (PPS) interests. Personal property security interests are claims on personal property – that is, all property except real estate – which give the secured party the right to seize the asset in the event of default and sell it or otherwise dispose of the collateral.

Significant economic benefits can accrue from a business's ability to efficiently mobilise all of its property in raising debt finance. Secured debt can benefit borrowers and lenders by reducing agency costs, limiting possible legal claims and minimising informational asymmetries. Consequently, access to and the cost of finance for, especially, small to medium sized businesses can be aided by a clear and low cost system for determining PPS interests.

Australia has well established arrangements for dealing with personal property securities that have allowed the growth of a lending market based on a variety of PPSs to develop where lenders, for the most part, have been able to protect their interests. However, the current arrangements have been criticised for being unduly cumbersome, not always providing clarity on priority and for gaps in their coverage. As a consequence, there has been, for a long time, a call for significant reforms to the laws relating to security interests in personal property.

The problems with the current system can be broadly categorised as either legal or economic barriers that inhibit the use of personal property as collateral. Legal barriers include laws and regulations that either provide disincentives or simply do not allow the use of certain types of property as collateral. Economic barriers include excessive transaction costs that reduce the attractiveness of using personal property as collateral.

The Attorney-General's Department options paper (AG's, 2006) outlines its approach to reform of the PPS system. While many of the details will only be determined following consultation with stakeholders, the broad intent of the proposed policy is clear. In particular, there is general widespread agreement that the new system should be comprehensive in coverage, provide legal certainty and be efficient. A commercially useful mechanism for secured loans will accomplish the following basic tests:

- It should improve the ability to create and register security interests at low cost.
- Create a system where the parties' security interests are clear. That is, the lender must first be able to determine before the loan is made, with ease, certainty and little cost, whether any other lender has superior claims to the security. Second, the lender's priority must be clear and protected from claims of third parties, including secured and unsecured creditors, the trustee in bankruptcy, and some purchasers of the security.
- It should cost little to enforce the security interests in a timely fashion.
- Securities should produce real commercial value for the lender when enforced. That is, net of the costs associated with verifying ownership, valuing the asset, enforcing the security interest and selling the asset, the asset should provide positive net benefit to the lender for it to be commercially viable.

The first step in any discussion of the likely benefits and costs of reform is the ability to answer the following questions:

- Will access to financing (particularly for small business) increase? If so, to what extent?
- Will the cost of financing fall? If so, by how much?
- What will be the reduction in administration, registration and search costs?
- Will there be a reduction is legal disputes?
- What will the setup/transition costs be? What determines the magnitude of these costs?

Whether access to credit will increase or not depends heavily on: 1) the marketability of the asset; 2) the appropriability and access to the asset;[1] and 3) transactions costs involved in verifying ownership, valuing the asset, and enforcing the security interest. Based in part on the experience in New Zealand which introduced similar changes earlier this decade, and partly on discussions with industry sources in New Zealand and Australia, it appears that the proposed system would affect access to finance as follows:

- The overall volume of lending is not likely to change substantially (at least in the short/medium term).
- There may be benefits in some pockets of the economy, (e.g. agriculture as it did in New Zealand where the changes allowed crops to be more readily used as collateral).
- There should be potential benefits for smaller financiers and new players as the changes should help to reduce entry barriers.
- For the larger financiers, the benefits will be related to the reduction in costs.
- In the longer-term, there is the potential for the debt market to expand further if the changes see more debt being securitised.

To the extent that unsecured lending is replaced by secured lending, the cost of debt would be reduced. New Zealand and Australian sources indicated a reduction in the lending rate for a loan secured with personal property (relative to an unsecured loan) can be in the order of three to four percentage points, with a further reduction in the lending rate if the loan was secured with real property. However, it should be noted that large a proportion of small to medium enterprise (SME) and micro-business lending uses the residential house as a security and the changes will not likely produce rates lower than those secured against mortgages. Our assessment on the cost of debt finance is that: while there will be potentially useful reductions in the borrowing rates for certain areas (e.g. agriculture and where SMEs use unsecured lending), they are not large enough to have macroeconomic effects.

To give a rough idea of the possible reduction in registration costs, it currently costs between $12 and $15 to register a security interest on the Register for Encumbered Vehicles (REVS) depending on the State of registration, while to register a charge with

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[1] Appropriability refers to the ability of the creditor to appropriate funds from the debtor through the sale of collateral and whether this will be affected by uncertain priority arrangements leading to competing priority interests.

the Australian Securities and Investment Commission currently costs $135. These fees contrast sharply this to the situation in New Zealand where a single electronic registry is available for all securities. This has resulted in significant reductions in direct costs – $NZ3 to register and $NZ1 to search the register.[2]

A single electronic registry will also reduce staffing costs associated with obtaining searches – industry sources suggest that the experience in New Zealand has been a reduction in staff numbers (with one business, a large law firm, reporting a reduction in registration and search staff from nine to only two and a half). Moreover, a new system that facilitates the use of simpler and standard documentation should also reduce the (legal) fees and administrative costs for borrowers and lenders by streamlining the loan application and approval process. As an example, one financier reported that reform in New Zealand led to a reduction in the number of standard contracts forms that need to be filled out from 32 to 2, and a greater use of paralegals in completing the documentation instead of externally sourced solicitors.

A clearer system operating under uniform laws throughout Australia and on a single electronic register where priority is easily determined and security interests relatively easily enforced should limit the incidence of legal disputes. New Zealand has only had two legal disputes in the four years after their PPS reform, both of which involved a party who failed to register their security interest and thus under New Zealand's new law meant that they relinquished their priority. Moreover, these cases were resolved quickly given the clarity of the new laws with regard to priority. Notwithstanding its still tentative nature, the experience in New Zealand means that we are happy to accept the assessment by legal experts that legal uncertainty/disputes will be significantly reduced post reform. This will not only reduce the direct costs of such disputes but also help to improve the efficiency of the lending market.

At this point, it is very difficult to ascertain the scale of transitional costs. As a very broad indication of the magnitudes involved, our discussions with industry sources implied that setup costs for the banking sector (e.g. devising new lending policies, credit risk assessment models, computer systems, procedural manuals and processes, and redesigning forms and retraining staff) could be in the order of $A50 to 100 million. The magnitude of transition costs will depend on the mode of transition. If re-registration is required, the costs might be substantial, while a 'grandfathering' system may limit these costs however delay the realisation of benefits. In some previous microeconomic reforms, there has been a tendency to underestimate both transition and compliance costs. In this case, the reforms are designed to reduce compliance and transaction costs; however, there will be transitional costs and it is important that transitional arrangements are tuned to minimise these costs (e.g. lead times etc.).

Overall, PPS reform is, in principle, an obvious and worthwhile microeconomic reform to pursue. Consideration of the above elements indicates that the proposed reforms will deliver material net gains to society and therefore should be supported.

At the same time, many of the details still need to be developed and, while we are confident that the benefits of reform will outweigh the costs, it is important to consider whether there are certain sections in the economy stand to lose from the reform. And if

[2] Note that Australian fees may not be cost reflective in some states, thus the gap between the pre and post reform registration costs may overstate the possible economic benefits of the changes – but it is still indicative of significant gains.

there are losers, whether they can easily be compensated or are the losses more pervasive. As it is, this report has failed to identify any groups in the economy that stand to lose, in net terms and in the long–term, from the reforms. Rather, any concerns tend mainly to relate to short-term transitional costs for both lenders and borrowers as well as to some areas of contention the general priority rules could be subject to a number of exceptions. It is the case that such (distributional) concerns have been the major impost to successful reform of the PPS system in the past and may be an obstacle that has to be overcome for this current attempt to be successful. However, given the net gains that each stakeholder group is likely to enjoy from the reforms in the long-term, there would appear to be a strong basis for an effective consultation process to finesse any differences.

In sum, our overall assessment is positive and we judge that if the reforms as enacted are in line with the stated objectives of the proposals, then there will be significant net gains realised. However, it should be noted that this is very much a preliminary assessment given the reform is still in the development stage and the lack of available data and information at this point.

1. INTRODUCTION

The Australian Attorney-General's Department commissioned Access Economics to report on the current Australian system dealing with personal property security (PPS) interests and assess the potential benefits of reform and what the associated costs of reform may be.

1.1 BACKGROUND

Collateral is an asset pledged by a debtor to a lender until a loan is paid back. If the debtor defaults, then the lender has the right to seize the collateral and sell it to pay off the loan. Personal property security interests are claims on personal property – that is, all property other than real estate – which give the secured party both a privileged position with regard to competing interests as well as the right to repossess and sell or otherwise dispose of the asset in the event of default.[3] In this way, personal property securities can be viewed as a subset of a broader range of assets that can be used as collateral to secure a loan.

Australia has well established arrangements for dealing with personal property securities that have allowed the growth of a lending market based on a variety of PPSs to develop where lenders, for the most part, have been able to protect their interests. However, the current arrangements have been criticised for being unduly cumbersome, not always providing clarity on priority and for gaps in their coverage. The ability of individuals and businesses – particularly small to medium sized businesses – to employ all their property in rasing capital may be constrained.

As a consequence, there has been, for a long time, a call for significant reforms to the laws relating to security interests in personal property (for example see Duggan, 1996). This report sets out to determine the important economic issues that need to be considered in the reform process, and where possible, identify the costs and benefits that are likely to arise out of the proposed reform.

1.2 STRUCTURE OF THE REPORT

Section 2 presents the economic theories of secured financing and discusses the role that collateral plays in reducing agency problems, limiting possible legal claims and minimising informational asymmetries. Section 3 briefly outlines the current system for dealing with personal property securities. Section 4 discusses the key features that PPS reform should have.

Section 5 then investigates the key issues that need to be considered in the reform process and identifies the potential benefits from reform and the associated costs. Where possible, this section attempts to articulate what the magnitude of these costs and benefits may be. Section 6 draws together the conclusions of this report. This is followed by an appendix which outlines key information and data that need to be gathered before any attempt at *quantifying* the costs and benefits would be possible.

[3] Note that personal property includes both tangible property (such as goods, livestock and equipment) and intangible property (such as receivables and intellectual property).

2. THE ECONOMIC BASIS FOR USING SECURED DEBT

Most economists will agree that collateral facilitates lending and investment, leading to enhanced productivity and ultimately economic growth. Thus before we attempt to determine the economic impact of moving from the status quo to a new PPS system, we first examine the reasons why we observe secured financing and, secondly, determine how the current system impacts on the use of collateral.

Offering collateral will not change the value of a firm if it does not change the firm's investment policy. When a firm's cash flow is fixed, pledging collateral can only alter the distribution of payments to various claimants but has no net benefit to shareholders (Fama, 1978) and makes the pledge irrelevant to financing decisions (Smith and Warner, 1979). To be relevant, a security agreement must alter the use of real resources.

Why then do firms offer collateral given that doing so involves costs for both lenders and borrowers? Lenders must value and monitor collateral, pay fees for registration and bear the higher administrative expenses of secured debt. Borrowers must prepare additional reports to debt holders and tolerate more restrictive asset usage. And both groups must resolve conflicts arising between secured and unsecured claimants through the use of collateral. That is, what benefits exist to compensate both borrowers and lenders for these costs of securing debt?

Secured debt can benefit borrowers and lenders by reducing agency costs, limiting possible legal claims and minimising informational asymmetries. We discuss these briefly in turn.

2.1 AGENCY COSTS

Pledging collateral may lower a firm's overall cost of debt by preventing asset substitution, reducing foreclosure costs, limiting claim dilution and mitigating the underinvestment problem. Once a loan is issued, borrowers can increase shareholder wealth by substituting away from low risk to high risk projects. Although bondholders can include provisions limiting the sale of certain assets, they have a stronger position with secured debt. In other words, a borrower can bind against asset substitution by offering as collateral any asset that provides a strong incentive toward repayment (Benjamin, 1979). As an example, pledging personal property discourages accepting high-risk projects or other opportunistic behaviour by raising the personal cost of default. That is, collateral can reduce monitoring costs by better aligning the interests of the borrower with those of the lender.

By deciding *ex ante* on the assets that will be transferred to each claimant, secured debt eliminates free-rider and hold-out problems during bankruptcy proceedings and therefore lowers the *ex post* foreclosure costs. The provision of collateral thereby allows a firm to substitute higher initial negotiation (registration) costs for lower expected future negotiation costs.

Collateral reduces the potential for claim dilution and thus lowers the cost of debt financing. A debtor can increase shareholder wealth at the expense of existing debt holders by issuing more debt, realising this, existing bond holders will either price debt to reflect the risk associated with increased financing or reduce the risk of increased leverage with covenants restricting future debt financing. Using a covenant involves monitoring and enforcement costs on the part of the existing debt holders. Collateral reduces these monitoring and enforcement costs by allowing the lender to foreclose on the assets of the borrower if the covenant is violated.

Underinvestment resulting from the 'debt overhang' problem articulated by Myers (1977) can also be alleviated with the use of secured financing. In some cases, a firm may reject a profitable project if only equity or unsecured debt financing is available. Partially financing a new project using unsecured debt allows the existing debt holders to capture some of the project's net value. A security provision eliminates this transfer of wealth by diverting to the firm's shareholders the payoffs that would normally accrue to unsecured creditors as a result of a reduction in future bankruptcy costs from the purchase of new assets.

Using a security provision, the new assets support the new debt in the event of bankruptcy, reducing the claims to existing creditors. Since new debt is priced to reflect a firm's new situation, shareholders will capture the payoffs by diverting them away from existing debt holders. Consequently, secured debt raises the value of any new project for the shareholders and reduces the chances that they will reject a positive net present value project.

2.2 LIMITING LEGAL CLAIMS

Secured debt can also increase shareholder wealth by limiting possible claims in the event of default (Scott, 1977). If a firm files for bankruptcy and priority is strictly enforced then a security interest allocates resources away from unsecured creditors to secured parties. Under perfect information and no transactions costs, this transfer of protection lowers the interest changed by secured creditors but raises the interest charged by unsecured parties (Schwartz, 1981).

2.3 INFORMATIONAL ASYMMETRIES AND SCREENING

When informational asymmetries exist between lenders and borrowers, that is, when banks cannot identify 'good' borrowers from 'bad' they face an adverse selection or 'market for lemons' problem (Akerlof, 1970). Stiglitz and Weiss (1981) show that this state of affairs can be characterised by credit rationing – a situation where, given loan applicants that appear equal, some receive loans and some do not even when they offer to pay a higher interest rate.

Their credit rationing model starts with the claim that the probability of default is related to the rate of interest charged on the loan. They argue for example, that at high rates of interest the borrowing pool will be composed of an especially high percentage of 'deadbeats'. Note how information asymmetry enters the argument. They assume that borrowers have a better idea of their likelihood of default than do lenders. High rates of interest therefore 'scare off' good borrowers, who expect to pay the loan. By contrast, high rates of interest do not scare off the 'deadbeats', who know their chance of having to repay the loan is slight in any case. This principle then imposes a constraint on how high a rate of interest a lender will charge. Many lenders will keep loan rates artificially low, to maintain a higher quality pool of borrowers and to increase their chances of being paid back.

In this setting the rate of interest will not necessarily clear the market for borrowing and lending. Banks keep interest rates down, but at those low rates demand exceeds supply. Lending must then be rationed.

Secured debt may therefore create value by allowing a high quality borrower to signal their credit worthiness to a lender (Chan and Kanatas, 1985). The borrower benefits through access to credit at lower interest rates but is worse off from the potential loss of the collateral in the event of default. With a high probability of default, the costs of secured debt outweigh the benefits; however, with a high quality borrower the benefits from reduced borrowing costs outweigh the relatively small expected costs associated with loss of collateral in the event of default. Therefore, when the lender has incomplete information about the quality of borrower, a borrower can signal their true worth by offering collateral – thereby reducing the screening costs for the lender.[4]

[4] Note however that Stiglitz and Weiss (1981) argue that it is not necessarily the case that a borrower is more trustworthy the more collateral they are able to mobilise.

3. THE CURRENT SYSTEM AND ITS PROBLEMS

Australia currently has a vast array of laws dealing with securities over personal property. Operating across eight jurisdictions with 70 acts, 25 departments and three ministerial councils, many of the current laws are derived from legislation which originated in England in the 1800s and which has only been amended in an ad hoc fashion in an attempt to make it relevant to the contemporary commercial environment.[5] The result is a patchwork of inconsistent laws that present with a number of deficiencies. The following briefly discusses the main deficiencies of the current system.

Incomplete Coverage

A significant concern is that it is currently not possible to register a security over some classes of property (e.g. accounts receivable, certain intellectual property) and certain security interests (e.g. retention of title, long term leases).

Overlapping Legislation

Some forms of security fall under two or more pieces of legislation and in some circumstances require registration in more than one registry. Moreover, there may be priority problems between competing interests registered in different registers.

Movement of Property and Security Providers

Security holders often conduct business in multiple jurisdictions or move themselves or their property between jurisdictions. To obtain comprehensive protection, registration in each jurisdiction may be required.

Form over Substance

This is a natural consequence of the ad hoc manner in which the laws pertaining to personal property have been amended over the years. The result is that like transactions are not treated alike under the law. There are many different types of securities which serve the same economic function (e.g. mortgages, charges and pledges) but are often regulated differently under the current arrangements. The law should focus on the economic function of the transaction instead of the form of the security or nature of the debtor.

Prescriptive Registration Requirements

Current law requires the inclusion of certain information in security arrangements to make them effective, regardless of whether this information has any real significance to the objective of obtaining priority for a particular interest. Moreover, it is currently compulsory to register a security interest. There is no sound policy base for compulsory registration and even less so for imposing criminal or civil penalties for failing to register an interest. This should be left to the parties on the basis that if the

[5] See the options paper "Review of the Law in Personal Property Securities", standing committee of Attorneys-General, April 2006 (attachment D) for more detail on current Australian legislation.

security holder feels that it is in their interests to protect their priority position, then they should register their interest.

Cumbersome Registration

The registration process itself is unnecessarily cumbersome, confusing and outdated under many of the existing statutes in respect of the type, form, and amount of information required to be registered.[6] It could be made much more streamlined, especially through the adoption of standardised electronic means.

3.1 THE ECONOMIC CONSEQUENCES

The problems identified in the preceding discussion can be broadly categorised as either legal barriers or economic barriers that inhibit the use of personal property as collateral. Legal barriers include laws and legislation that either provide disincentives or simply do not allow the use of certain types of property as collateral.

Economic barriers include excessive transaction costs that reduce the 'attractiveness' of using personal property as collateral. These costs are associated with the multiple register searches, multiple documentation and multiple registrations in various states under various acts that is required under the current system. The present system increases the operating costs of users, particularly where registration needs to be effected in multiple registries. Additionally, financiers and purchasers often have no simple means of checking whether property is unencumbered. The complexities of the present laws slow down business transactions. Moreover, a system with multiple registries both within a given jurisdiction and in different jurisdictions increases the costs to governments of maintaining multiple registries. Whatever the reason (legal or economic), we argue that, broadly, the current system 'restricts' the set of personal property available for securitisation.

Is the lack of collateral a constraint on economic activity? Given the previous discussion, constraining the set of assets over which lenders are able to take as collateral stifles the market's response to problems arising from agency costs associated with debt and asymmetric information between lenders and borrowers. As a consequence debtors either face higher borrowing costs or are 'rationed' out of the market and are unable to access credit all together. This is likely to have its greatest impact for smaller participants, both lenders and borrowers, although the how substantial the impact is in practice is an open question.

One of the reasons for the reluctance of financiers to take and rely on this form of security is the lack of certainty in the existing law. Due to the difficulties with taking security over receivables and inventory, financiers tend to demand security on a form of real property and guarantees from the company directors. The present laws increase the risks for financiers and have the effect of limiting the available credit. In addition, the complexity of the laws increases the costs of legal advice on the taking and administering securities over personal property.

[6] See the options paper "Review of the Law in Personal Property Securities", standing committee of Attorneys-General, April 2006 (attachment E) for more detail on the concerns with the existing arrangements.

Restrictions on collateral also distort economic activity towards registrable property. For example, as real estate security is a particularly convenient form of security partly facilitated by a legal and regulatory environment that minimises the risk of lending for real estate, at least relative to other forms of property. This permits lower interest rates for such loans and leads the market to allocate more capital towards operations intensive in real estate.

Similarly, hotels and commercial buildings will be relatively easy to finance. By contrast, a factory operating in rented space may find it difficult to finance machinery because it cannot mortgage the real estate. A service company (e.g. bus, taxi) that requires inputs of durable equipment and relatively little real estate may find obtaining financing difficult. A landless farmer may also find it difficult to finance equipment.

The existing arrangements also stifle financial innovation as new types of property are devised and are not able to be registered. This is particularly problematic since risk taking entrepreneurs who are frequently seeking new capital are those that tend to be at the forefront of developing new classes of property. As a consequence businesses may either find it difficult to obtain financing or have to rely more heavily on equity than would otherwise be the case. This inability to leverage means that some projects with a positive net value and benefit to the economy are not undertaken.

For some considerable time the relative value of personal property compared with real property has been increasing and the primary generation of wealth in advanced countries today is derived from personal property including intangibles, information and intellectual property. To be competitive, a modern economy must be able to harness these types of property for the purposes of rasing debt capital. On this point, restrictive laws on personal property securities may also narrow the distribution of credit. Although this is not an inefficiency of the current system per se, it may have negative political connotations. While both wealth and income are distributed unevenly, the distribution of real estate is even more uneven. Problems with using personal property as collateral may therefore lead the present system to distribute credit even more narrowly than the distribution of wealth.

4. KEY FEATURES OF REFORM

The process of reform has not yet provided a definitive model of what the new laws governing personal property securities might look like. Nevertheless, there is general agreement that the new system should be comprehensive in coverage, provide legal certainty and be cost efficient. A commercially useful mechanism for secured loans must minimally accomplish the following basic tests:

- It should improve the ability to create and register security interests at low cost.
- Create a system where the parties' security interests are clear. That is, the lender must first be able to determine before the loan is made, with ease, certainty and little cost, whether any other lender has superior claims to the security. Second, the lender's priority must be clear and protected from claims of third parties, including secured and unsecured creditors, the trustee in bankruptcy, and some purchasers of the security.
- It should cost little to enforce the security interests in a timely fashion.
- Securities should produce real commercial value for the lender when enforced. That is, net of the costs associated with verifying ownership, valuing the asset, enforcing the security interest and selling the asset, the asset should provide positive net benefit to the lender for it to be commercially viable.

The relevant stakeholders have also indicated a number of key design features that, in their view, are core to achieving any benefits from reform. We briefly outline and discuss these below:

- The system should make it possible to register all personal property and debtor types.
- It should facilitate the use of simpler and standard documentation.
- There should be a single national electronic registry for all security types which is simple and cost effective and allows streamlined and automated processes for searching, registration and discharge.
- There should be a legal regime that is national and uniform throughout Australia. On this, the balance of opinion in the finance sector seems to favour of a Commonwealth statute.
- Priorities should depend primarily on the date of registration.
- More than one security interest is allowed to be registered over the same asset; however, the first registered security holder is permitted to secure further advances against their security without losing priority.
- Registration indexing should be simple, either by debtor name (debtor indexing) for securities without unique identifying information (e.g. inventories or livestock) or by identification of the asset (asset indexing) for assets that can be easily identified by serial numbers (e.g. motor vehicles, boats).
- A transition period of between two to five years to allow lenders to devise lending policies, credit risk assessment models, computer systems, settle procedural manuals and processes, redesign forms and train staff.

5. COSTS, BENEFITS AND IMPORTANT ISSUES TO CONSIDER

This section attempts to outline the benefits and costs associated with the reform process. A detailed quantitative assessment of the costs and benefits is not feasible at this point. There is a lack of readily available information regarding the current lending patterns and the associated costs of financiers in Australia. Moreover, the uncertainty regarding what exact form the new system may take on makes it difficult to gauge the extent to which benefits and costs will be realised. It may be possible to draw on the experiences or similar studies of other countries to give us an idea of the net benefits/costs of some hypothetical regime switch, although this has not been attempted here.

Notwithstanding these difficulties, we try to provide an indication of the orders of magnitude involved at certain points in the discussion. We will also discuss the important issues that need to be considered when moving forward with the reform.

The first step in any discussion of the likely benefits and costs of reform is the ability to answer the following questions:

- Will access to financing (particularly for small business) increase? If so, to what extent?
- Will the cost of financing fall? If so, by how much?
- What will be the reduction in administration, registration and search costs?
- Will there be a reduction is legal disputes?
- What will the setup/transition costs be? What determines the magnitude of these costs?

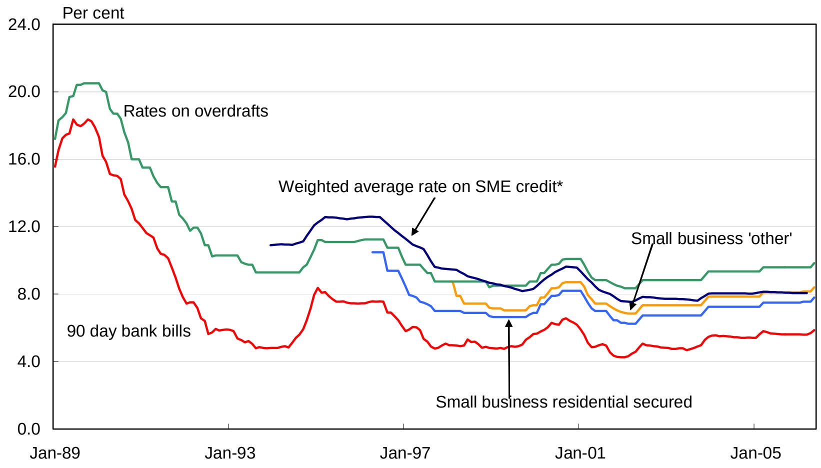
5.1 ACCESS AND COST OF DEBT FINANCING

Reform that removes the legal barriers to using certain types of property as well as reducing the costs involved in using personal property (thereby reducing the economic barriers and making personal property more 'attractive' to both borrowers and lenders) expands the set of collateral available to be used to secure a loan. Previous discussion regarding the benefits of secured debt suggests that expanding the set of personal property available for the purposes of collateral will reduce problems associated with agency costs and informational asymmetries. With this, it is expected that access to finance should increase at reduced rates of interest.

Comments from some industry sources seem to echo this broad sentiment. Nevertheless, the experiences of bankers in New Zealand suggest that the volume of financing they provide has probably not increased significantly (although, it could still be too early for the full effects to be realised). Rather, there has been an increase in the willingness of bankers to accept some forms of property as collateral that prior to their 2002 reform were not usually used (e.g. crop mortgages have become more valuable in New Zealand post reform).

It was also noted by industry sources in New Zealand and Australia that the reduction in the lending rate for a loan secured with personal property (relative to an unsecured loan) is in the order of three to four percentage points, with a further reduction if the loan was secured with real property. Nevertheless, it should be noted that a large proportion of SME and micro-business lending uses the residential house as a security and the changes will not likely produce rates lower than those secured against mortgages. Chart 1 illustrates the differences in lending rates for small business although the available series do not provide a direct comparison between the differential in rates due solely to whether collateral is provided.

CHART 1: LENDING RATES FOR SMALL BUSINESS



Source: RBA

* The RBA only provide estimates once a quarter. Estimates for the intervening months are based on simple

Comments by representatives of the National Australia Bank suggested that the experience for Australian banks is expected to be similar to that of banks in New Zealand post reform.

Australian bankers seem to believe that most of the benefits of reform for them will stem from a cost reduction (e.g. fall in search costs) in conducting business in personal property securities and while some forms of personal property will be more valuable under a new system, it is unlikely that they will be prepared to accept more 'exotic' forms of property as collateral. Consequently, access to formal bank credit may not change markedly post reform in Australia.

However, this is not to say that all financiers will not be willing to accept these more 'exotic' forms of property that will be created post reform. It is therefore possible that not all borrowers who are better collateralized under a new system will continue to be constrained in their access to financial services post reform – only those who rely on formal bank credit may continue to be credit constrained.

This discussion raises some important practical issues that need to be considered when determining the likely impact that an increase in the availability of personal property securities will have on a small business' ability to access credit. While all forms of collateral are expected to perform the functions and provide the benefits outlined in Section 2, creditors prefer some forms of collateral more than others and these preferences vary from country to country, from creditor to creditor and over time. Even for the same creditor, the preference for say, real estate may give place to another form of collateral (and vice versa), possibly as a result of changed procedural disposition in the execution of mortgages. Basically, one can distinguish property based on the following criteria:

- Marketability of the asset.
- Appropriability and access to the asset in comparison to other lenders.
- Transactions costs involved in verifying ownership, valuing the asset, and enforcing the security interest.

Marketability refers to whether there is a secondary market on which the asset can be sold at low cost. Assets that have a readily available secondary market will have value to the lender, while those where a secondary market does not exist or where re-sale is costly will be less valuable. Of course, marketability will vary from asset to asset and over time. As an example, motor vehicles have a well functioning secondary market that is easy to access, while trademarks have value and can be resold although through negotiation and at higher cost due to the lack of a secondary market. It is also possible that some types of property, net of costs, will not provide any real value to the lenders.

Appropriability refers to the ability of the creditor to appropriate funds from the debtor through the sale of collateral and whether this will be affected by uncertain priority arrangements leading to competing priority interests. A new system which provides a single electronic registry governed by laws that are uniform across Australia (e.g. priority should depend only on the time of registration) will make priority easier to determine and thus make all forms of property more valuable.

The transaction costs of verifying ownership and enforcing security interests should fall under a system with a single national electronic register. However, the costs associated with valuing the asset will vary substantially from one type of property to another. Assets that are able to be resold on a secondary market are relatively easy to price while other assets such as art or trademarks will incur greater costs in their valuation. It is plausible (especially with regard to the transaction costs criterion) that the size of the loan determines whether and what form of collateral is taken. As an example, it makes little sense to demand a mortgage for a $5000 loan. With increasing loan size, collateralised lending becomes more widespread, but also costlier in absolute terms.

On the questions of access to and cost of debt finance, our views are:

- The overall volume of lending is not likely to change substantially (at least in the short/medium term).
- There may be benefits in some pockets of the economy, (e.g. agriculture as it did in New Zealand where the changes allowed crops to be more readily used as collateral).
- There should be potential benefits for smaller financiers and new players as the changes should help to reduce entry barriers.
- For the larger financiers, the benefits will be related to the reduction in costs.
- In the longer-term, there is the potential for the debt market to expand further if the changes see more debt being securitised.

Given the lack of precise data on the lending patterns of creditors, the cost of credit and how these may change post reform the best we can do (in terms of better quantifying the net gains/losses) at this stage is to look at similar studies that have been conducted for other countries to give us some rough guide as to the potential expansion in lending post reform. Most of the work in this area is conducted on a case studies basis for particular (developing) countries (see for example, World Bank, 1994). In the United States, personal property accounts for half of the non-residential capital stock and two-thirds of the corresponding gross investment. Overall 70 per cent of loans in US are secured (industry sources suggest that this is similar to the figure for Australia); contrast this to Bolivia, Argentina and other developing countries where personal property cannot be used as collateral and up to 90 per cent of loans are unsecured and most small business cannot get financing.

More precisely, the World Bank (1994) compares data for Bolivia and the United States and shows that in Bolivia only about 10 per cent of secured loans are granted on the back of personal property securities, while in the United States about 40 to 50 per cent of secured loans are granted using personal property as collateral (30 to 40 per cent are backed with real estate). Moreover, the interest differential between Bolivia and the United States – due only to problems with using personal property as collateral – is in the vicinity of 14 to 50 per cent. The report concludes that if addressing the laws governing the use of personal property as collateral led to a similar expansion in lending and drop in interest rates, total lending for small business could rise by as much as $675 million (approximately 2 per cent of Bolivian Gross Domestic Product). Although Bolivia and other developing countries are not comparable to Australia, this evidence is suggestive that reform could lead to improved access to financing.

It is worth noting that while industry sources in New Zealand have indicated that the volume of lending has not increased significantly post 2002, the percentage of (total) loans that are backed with real estate is still in the vicinity of 70 to 80 per cent – compared with 30 to 40 per cent (of secured loans) in the United States. If, over time, the new PPS system in New Zealand facilitates a change such that its collateral situation were to mirror that of the United States, we may indeed see significant benefits in terms of increase access to finance and/or lower borrowing rates in the longer term.

5.2 REDUCTION IN TRANSACTION COSTS

Other expected benefits to come out of reform are the reduction in registration, administration and search costs. To give a rough idea of the possible reduction in registration costs, it currently costs between $12 and $15 to register a security interest on the Register for Encumbered Vehicles (REVS) depending on the State of registration.[7] While to register a charge with the Australian Securities and Investment Commission currently costs $135.[8] Moreover, the current law may demand multiple registrations of the same asset. Contrast this to the situation in New Zealand where a single electronic registry for all securities means registration is available at significantly lower cost – $NZ3 to register and $NZ1 to search the register.[9] Note that Australian fees may not be cost reflective in some States, thus the gap between the pre and post

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[7] Register for Encumbered Vehicles, available at: ACT **http://www.revs.nsw.gov.au/**; New South Wales **http://www.revs.nsw.gov.au/**; Northern Territory **http://www.revs.nsw.gov.au/**; Queensland **http://www.fairtrading.qld.gov.au/**; South Australia **https://www.ecom.transport.sa.gov.au/**; Victoria **http://www.vicroads.vic.gov.au/**; Western Australia **www.docep.wa.gov.au/revs/**; Tasmania (Not Available).

[8] Australian Securities and Investment Commission, *Fees for Commonly Lodged Documents* pg. 7, available at **http://www.asic.gov.au**.

[9] Personal Property Securities Register, *Services and Fees*, available at **http://www.ppsr.govt.nz**.

reform registration costs may overstate the possible economic benefits of the changes – but it is still indicative of significant gains.

Search costs are more difficult to get a handle on. Most of the current search costs are staffing costs. Industry sources suggest that the experience in New Zealand has been a reduction in staff (required for PPS searches and related tasks). The need for multiple searches and multiple documentations under the current system significantly increases the time and cost involved relative to a New Zealand type system where only one search is necessary at the cost of $NZ1.

A new system that facilitates the use of simpler and standard documentation should also reduce the (legal) fees and administrative costs for borrowers and lenders by streamlining the loan application and approval process. As an example, reform in New Zealand led to a reduction in the number of standard contracts from 32 to 2. If reform led to a similar change in Australia, the reduction is costs will be significant.

To give a rough guide, representatives of one of the major banks indicate that, under the current situation, non-standard securities prepared by in-house Legal for personal property security attract set fees of $250. Stock mortgages have a fee of $350 and ships mortgages are $500. For the more novel types of personal property, external lawyers usually need to be employed. When external lawyers are involved in taking non-standard securities, the cost is usually at least $1,000 and can range up to $3,000 depending on complexity. These figures do not include the time involve in monitoring external lawyers.

The time incurred for processing ranges from one to two hours per matter and includes: obtaining/vetting searches, preparing securities, arranging for/advising on registration requirements and so on. Total time spent on this kind of work by all State legal departments is approximately 4,800 hours annually – not including time spent on supervising external law firms. In addition to this figure would be the time taken by the bankers in communicating with in-house Legal.

Under a new system with simpler and standard documentation, the cost to prepare a one or two page document that could be done in-house by a centralised area of the bank would be commensurate to the current cost for standard securities (e.g. good mortgage, bill of sale, etc.). That is, the time taken and hourly rate of the document preparation office.

Standard securities are currently generated electronically from the system and are prepared by bankers, not Legal. As they are relatively simple precedents, it does not take very long to do – less than half an hour as a rough estimate (although time would be spent on obtaining searches) – and at significant lower costs on account of the reduced need for legal expertise.

On the reduction in transaction costs, our assessment is that there seems to be substantial gains to be realised from reform.[10]

[10] It may be possible to get a broad indication of the order of magnitude of the reduction in transaction costs (in the banking and legal system) from surveys, some information for which may be forthcoming from industry participants. More details are contained in the appendix.

5.3 LEGAL DISPUTES

Legal disputes arising from competing priorities are not pervasive under the current system but nevertheless do occur, and when they do, are extremely costly. Under the current system, there are variations across states with regard to personal property securities law which leave too much room for interpretation and consequently conflict, while multiple registers makes it possible for there to be competing priority interests on the one asset. A system that has uniform laws throughout Australia and operates on a single electronic register where priority is easily determined by simple rules (e.g. priority might be determined by the date of registration) and security interests easy to enforce should limit the incidence of legal disputes.

Since the 2002 reform in New Zealand, there have only been two legal disputes over priority, both of which involved a party who failed to register their security interest and thus under New Zealand's new law meant that they relinquished their priority. Moreover, these cases were resolved quickly given the clarity of the new laws with regard to priority. If the New Zealand experience is an indicator of what uniformity and clarity in the laws coupled with a single electronic register will bring, the reduction in incidence as well as length of legal disputes post reform may be significant.

It is worth mentioning here that there are a number of special cases (see Attachment F of the Options Paper) where the general priority rules could be subject to a number of exceptions. Some of the special cases proposed as exceptions may result in an increase in the potential for disputes, for example, co-mingled goods where identification, evidentiary and tracing issues will become important. These special cases are complex and require more detailed examination and consultation with the interested parties.

Our overall view is given the, albeit still tentative, experience in New Zealand, we are happy to accept the assessment by legal experts that legal uncertainty/disputes will be significantly reduced post reform. This will not only reduce the direct costs of such disputes but also help to improve the efficiency of the lending market. Cuming, Duggan and Zielgel (2003) provide a comprehensive discussion of the legal issues that need to be addressed with regard to these types of special cases.

5.4 THE SET-UP AND TRANSITIONAL COSTS

Although reform will clearly provide a number of benefits that have already been articulated, the question remains as to the costs associated with reform. The explicit cost of reform to government will include:

- Cost of drafting new legislation. That is, the cost of (possibly) lengthy negotiations with industry as well as the state governments in deciding the exact form the legislation will take and whether referral of state powers would be a viable option.
- Cost of creating the new register (e.g. cost of employing IT personnel).
- Cost of an information and education campaign to familiarise users with the new arrangements.

While these costs will initially be borne by the federal government (and ultimately tax payers), the personal property security system exists to protect creditors, and to facilitate borrowing by lenders, and they therefore should, in principle, bear the costs involved in setting up the system. The system should also seek to minimise the costs to people who are not parties in a securities transaction. This type of 'user-pays' system means that the cost of setting up an electronic register and devising new legislation will ultimately be borne by both lenders and borrowers – presumably through fees for registering and searching the register. Having said this, it is important that, to the extent that it is feasible, the fees should be cost reflective and not revenue generating. Excessive fees will reduce the net benefits from proceeding down the path of PPS reform.

Lenders will also face a number of set up and transitional costs on top of those that have just been discussed. There needs to be a sufficient lead time to prepare for a new system. A lengthy lead time would make it possible to defray the associated costs over a longer period of time and therefore reduce the impact on any particular year. Most seem to agree that a period of *at least* two years prior to the system goes 'live' is essential. For reforms involving the establishment of a national register, time would be needed to develop the infrastructure to support the PPS register. Other set up costs that lenders will face include devising new lending policies, credit risk assessment models, computer systems, settle procedural manuals and processes, redesign forms and retrain staff. After discussions with industry sources, we judge that these set up costs could be of the order of $A50 to 100 million for the banking sector.[11]

Another important question that must be addressed is: what do we do with existing securities? That is, to what extent should securities that exist under the current system be captured on any new national register?

There are a number of options available. Broadly, these can be classed as:

- Re-registration
- Dual (grandfathering) system

The first option would to arrange for data in the existing registries to be transferred to the new registry, or to require security holders to re-register with the new register. New Zealand required existing security holders to re-register. This option is not favoured by the banking industry. Their premise to this is that for large scale financiers such as banks, the multitude of securities that would need to be re-registered would be too costly and would therefore be a major impost and not supported.

The second option would be to capture only securities created after a particular date from the commencement of the national PPS system legislation. All securities created after this date would fall under the new national system. All existing interests would be retained under the old system without any change to priority or rights of enforcement and unaffected by later PPS interests registered under the new PPS system according to the respective pre-existing laws that apply to them.

This option may be appropriate for securities with a short registration life, so that securities before that date would have expired by the time the register is online. However, this approach may be problematic for longer lived and perpetual securities. Under this dual system, one would not want to 'grandfather' these longer lived securities indefinitely. There must be some point in time after the new register goes 'live' which all pre-existing securities must be brought under the new regime. Industry

[11] This figure is based on conversations with industry sources and needs to be confirmed with data.

sources have indicated that this grace period should reflect the (average) life or churn rate of their security portfolios.[12]

Thus in determining this time period there needs to be an understanding of what the makeup and characteristics of the representative financier's security portfolio would look like. The appendix highlights examples of the sort of questions that would need to be answered by industry in order to ascertain the relevant information.[13] Moreover, it is desirable that in determining this grace period there be an assessment of the cost (i.e. re-registering) and benefits (i.e. reduction in the period which interested parties need to search more than one register) of setting a particular time after which all pre-existing securities must be re-registered. Industry sources indicate that, *prima facie*, this grace period should be somewhere between two to five years.

Both approaches have their benefits and drawbacks. The first involves larger 'upfront' costs – particularly for larger financiers such as banks – however brings with it the immediate benefits of the new and improved national system. The second approach minimises the transition costs however delays the realisation of any benefits from the new system (e.g. reduced search costs). There are clear tradeoffs with either approach, and while a cost benefit analysis could be done to determine the best method of transition, we can make an inference about the relevant costs and benefits by letting the stakeholders reveal their own preferences. Thus deciding which path to go down should be done in close consultation with the stakeholders.

Our view is that there is a tendency to underestimate transition and compliance costs in many microeconomic reforms. In this case, compliance and transaction costs will fall significantly; however, there will be transitional costs and it is important that transitional arrangements are tuned to minimise these costs (e.g. lead times etc.).

5.5 THE NET BENEFITS/COSTS

All things considered, is it possible at this stage to make an assessment of whether PPS reform will bring with it net benefits to society? And if so, what the likely magnitude of these net gains will be? Quantitative studies of this nature for developing countries (see for example World Bank, 1994) suggest the welfare cost of prohibitive laws and infrastructure to the use of personal property as collateral is in the range of five to ten per cent of Gross Domestic Product. This figure is very substantial, but not comparable for Australia – although it possibly gives us an upper bound on the possible welfare cost of the current system.

Proving a comprehensive quantitative study of the benefits and costs of PPS reform is outside the scope of this report and would require much more thought and resources to achieve. Nevertheless, as a starting point, more data need to be collected on the lending patterns of banks, the cost of debt, search and registration costs, cost of legal disputes, makeup and characteristics of a standard security portfolio etc. – presumably through some sort of survey. Details of possible questions that need to be addressed

[12] Churn rate refers to the time in which a certain security interest will be reassessed over the course of normal business operations.

[13] The Australian Bankers Association has started this process and sent out a preliminary survey to its members containing some of the questions outlined in the appendix. While the results of this survey will be useful as a starting point, a more comprehensive survey will need to be conducted at some point in time.

in the survey are outlined in the accompanying appendix. We would then need to compare the current system with some counterfactual to make an assessment of the welfare gains/losses of reform. The lack of an observed counterfactual should not be a severe impediment so long as we can make an inference on the likely impact that reform will have on the data under some plausible assumptions.

Notwithstanding this, what we can say at this early stage is: given the wealth of notional support for the proposed reform by all relevant stakeholders it seems clear that PPS reform is at least perceived to bring with it net welfare gains to society. The current (and previous) impost to PPS reform being successful seems to stem from (political) concerns about the *distribution* of potential gains and loses. Table 1 summarises the discussion in this section, outlining the main benefits and costs of the key features of reform.

5.6 THE DISTRIBUTION OF GAINS AND LOSSES

Broadly speaking, from an economic perspective, policy changes that lead to Potential Pareto (Kaldor-Hicks) improvements should be pursued (i.e. aggregate benefits outweigh aggregate costs). The distribution of these gains and losses is not so much of a concern so long as gains outweigh the losses. This is not to say that distributional concerns are not important, they are and will ultimately determine the final appearance of the new PPS system. Moreover, the case for reform is always much stronger if net losers are minimal or can easily be compensated.

We have suggested that the notional support of this proposed reform from the relevant parties seems to suggest that PPS reform will bring with it net benefits to society. What is more, this report has failed to identify any groups in the economy that stand to lose significantly in the long term from reform. Thus it seems clear that, in principle, PPS reform should be supported.

Notwithstanding this, there will be some short term costs associated with the transitional period for lenders and borrowers as well as some areas of contention with regard to the number of special cases (see Attachment F of the options paper) where the general priority rules could be subject to a number of exceptions.

These types of distributional concerns will generally be an impediment to any reform process and thus should be discussed in detail and in close consultation with all the relevant stakeholders in order for there to be agreement before progress can be made. By way of example, some of the concerns that have been raised by the stakeholders include, but are not limited to, the following:

- The position of floating charges relative to purchase money security interests (PMSI) with regard to priority. Under the proposed PPS system, an equipment financier that requires a security over a specific item of equipment would obtain priority over the holder of a floating charge. Asset financiers would gain at the expense of working capital financiers – the equipment financier claiming the purchase money security interest priority would be entitled to first right of enforcement of the security despite the effect this may have on the business. The theory of PMSI priority – see Cuming, Duggan and Zielgel (2003) for a discussion – is generally accepted as the common law position. However this is far from being universally agreed upon and academic debate continues.
- Referral of powers by the States versus applied law. A new PPS system would require uniform laws and legislation across state boarders. The preference of

most stakeholders is for the states to refer their powers to the federal government. States would lose autonomy in this area and, as a consequence, may be averse to going down a path which involves the referral of powers.

- Under the new system, the need to register certain security interests that were not able to be registered under the old imposes a cost on the individuals who previously did not have to register their interest (e.g. retention of title holders). Although, if registration were voluntary then it would be left up to the security holder to determine whether the benefits of protecting their interest outweigh the registration costs.

Table 1: The Costs and Benefits of Reform

Proposed Change	Potential Benefits	Costs
Make it possible to register all personal property and debtor types	❑ Increased access to credit, particularly for small business and farmers ❑ Reduction in the cost of debt finance	❑ Certain security holders will now have to register when previously they did not have to e.g. retention of title holders.
Facilitate the use of simpler and standard documentation	❑ Streamlining of loan application and approval process i.e. a reduction in the amount of paper work ❑ Reductions in other borrower costs e.g. legal expenses, fees	❑ Set up costs i.e. design of new documentation etc.
A legal regime that is national and uniform throughout Australia. On this, the balance of opinion seems to be in favour of a Commonwealth statute	❑ Enhanced clarity in laws ❑ Increased clarity with regard to priority ❑ Reduction in compliance costs ❑ Reduction in legal disputes	❑ Set up costs i.e. drafting new legislation etc. ❑ Negotiation costs i.e. with the states on the referral of power
A single national electronic registry for all security types	❑ Reduction in registration costs ❑ Only need to register once ❑ Reduction in explicit search costs ❑ Only need to search one register leading to a reduction in staffing costs ❑ Reduction in cost of verifying ownership of asset etc. ❑ Increased clarity with regard to priority leading to a reduction in legal disputes	❑ Set up costs including devising new lending policies, credit risk models, computer systems, procedural manuals and processes, forms and retrain staff. ❑ Transitional costs ❑ Re-registration (NZ system) or Dual (grandfathering) system
A transition period of between two to five years	❑ Minimise set up and transition costs	❑ Benefits of reform delayed

6. CONCLUSION

Personal property security interests are claims on personal property – that is, all property except real estate – which give the secured party both the priority and the right to seize the asset in the event of default and sell it or otherwise dispose of the collateral. A business should, in principle, be able to efficiently mobilise all of its property in raising debt finance.

However, the current arrangements in Australia dealing with personal property securities inhibit their use due to the existence of both legal (e.g. differing state legislation) and economic (e.g. high transaction costs) barriers. As a consequence, for over 30 years there has been agreement that there should be significant reform to the law and infrastructure relating to interests in personal property. Despite this, previous attempts at reform have failed to overcome most of the defects in the present system. In recent years, there has been renewed interest in pursuing personal property securities reform. This report identified and discussed the important economic issues that need to be considered in the reform process, and where possible, identified the costs and benefits that are likely to arise out of the proposed reform. The key questions that the report identified as needing close examination in the cost-benefit debate were:

- Will access to financing (particularly for small business) increase? If so, to what extent?
- Will the cost of financing fall? If so, by how much?
- What will be the reduction in administration, registration and search costs?
- Will there be a reduction is legal disputes?
- What will the setup/transition costs be? What determines the magnitude of these costs?

The PPS reform is, in principle, an obvious and worthwhile microeconomic reform to pursue. The support for the proposed reform from the relevant stakeholders seems to suggest that changing the current arrangements dealing with personal property securities will bring net gains to society and therefore should be supported. Also, this report has failed to identify any groups that stand to lose, in net terms and in the long term, from the reforms, thus the case for reform is strong.

At the same time, there will be important transitional costs to be managed and minimised. Consultations on a few issues relating to the priority rules also may need to be carefully handled although, given that all the main stakeholders should gain overall, it would seem that any difficulties should be able to be finessed.

In sum, our overall assessment is positive and we suspect that if the reform process is done well that there will be significant net gains realised. However, it should be noted that this is very much a preliminary assessment given the reform is still in the development stage and the lack of available data and information at this point.

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8. APPENDIX: POSSIBLE SURVEY

The qualitative analysis in the text suggests that if the reform process is done well then there should be significant net benefits to society. However, to reliably *quantify* the benefits and the associated costs of reform, information such as the lending patterns of banks, the cost of debt, search and registration costs, cost of legal disputes, makeup and characteristics of a standard security portfolio etc from the relevant stakeholders would be needed. In addition, the quantitative analyse would aim to assess how these data may change, if at all, following the enacting of the reforms.

Information that will need to be gathered include, but not exclusive to, the following:[14]

On the Access to Credit

- Type of lending institution
- Total loans
- Break up of loans into type of debtor e.g. personal, small business etc.
- Break up of loans into secured vs. unsecured
- Break up of secured loans into secured with real estate vs. secured with personal property
- Break up of personal property into various types/classes e.g. livestock, equipment etc.
- Would you be more inclined post reform to take personal property to secure a loan? And to what extent?
- What types of personal property will be favoured?

On the Cost of Debt

- Interest rate charged on unsecured loans vs. secured with real estate vs. secured with personal property
- How might this change post reform?

On the Administration, Registration, & Search Costs

- Administration costs/Fees charged on unsecured loans vs. secured with real estate vs. secured with personal property
- Current search costs? E.g. staffing expenses.

On the Incidence and Magnitude of Legal Disputes

- Current number of legal disputes?
- Current cost of legal disputes?
- Proportion of disputes to securities/loans?

[14] Note that what is proposed is merely suggestive. Depending on the goal of the survey, it can encompass as many or as few of these questions as needed. However, for a comprehensive study that attempts to quantify the costs and benefits of reform, the more detail that can be obtained through the survey the better.

- Proportion of dispute costs to securities/loans?

On the Transitional Costs

- What would the cost of re-registration be? This could possibly give us an upper bound on the transition costs.
- To get a handle on what transition might be and how we might minimise them, we need information like the average lifespan and churn rate of securities to determine an appropriate time for adjustment to the new system.
- The Australian Bankers Association has already sent out a preliminary survey to its members to try and ascertain some of the information needed to estimate the likely magnitude of re-registration costs versus the costs of a 'grandfathering' approach to transitioning from the old to new system. The questions that they asked in their survey were:
  - What types of personal property securities do banks hold?
  - Over what types of property they are held?
  - How they are held (for example in branch security packets, centrally etc)?
  - What proportion is registered on some PPS register?
  - What proportion has no facility for registration?
  - How long have they been held and what estimate can be made of their likely retirement/discharge?
  - Are they conveniently identifiable and recorded and if so in what manner?