

# Reevaluating Model Laws: Transplant and Change of Financial Law in Vietnam

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## I. Introduction

### 1. Reason of Model Laws: Hidden Agenda

Emphasis started to be added by new-institutional economics to the building of “institutions” in the early 1990s as preconditions to realize successful economic growth through foreign investments, or the “Washington consensus” which initiated the introduction of model laws particularly in the areas of economic law directly relevant to foreign investment promotion.<sup>1</sup> Although these soft laws have never been formally binding as international law, they still have exercised direct influence over the process of formal law-making in many developing and transition economies, coupled with such *de facto* pressures as conditionalities to structural adjustment loans,<sup>2</sup> and ratings by indicator surveys.<sup>3</sup>

In the 2000s, as the goals of development are interpreted in broader contexts of poverty alleviation, empowerment, and peace building, and the original goal of economic growth is considered only available through the pursuit of sustainable development, the goals of law-making have as well been discussed in a diversified context (Sen 2000), while making it outdated to build legal institutions for the sake of the Washington consensus (Trubek 2006). Model laws, therefore, should have faded out from the scene in this new stage, according to the fate of the Washington consensus. Nevertheless, they remain influential, and are even more strengthened in the 2000s with repeated revisions and renewed linkages with various legal indicators. For instance, in 2004 the World Bank renewed its famous insolvency law model that was first made public in 1999 and finalized in 2001 (*see* World Bank 2001/2004) which is currently rigorously applied in a strengthened link with the “ROSC (Reports on the Observance and Standards and Codes)”; and the European Bank for Reconstruction

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and Development (EBRD) developed its “New Legal Indicators Survey” in 2003.

Why can model laws remain influential? Perhaps, the tactic manipulation of ultimate goals of law-making by the same development agencies explains this survival of model laws. Looking into the logical frameworks (log-frames) of major donors in contemporary legal reform projects, we encounter diversified ultimate goals such as “empowerment,” “rule of law,” “security,” etc. referring to the faded importance of economic growth as a goal, as well as post-Washington consensus type project-level goals as improvements of criminal law, anti-corruption law, and anti-money laundering law.<sup>4</sup> However, we should realize the unchanged substance of projects in the input-level of the log-frames, containing similarly pro-investor legal models from the 1990s. As far as none is concerned this gap between the levels of ultimate goals and project inputs, development donors can easily continue the hidden agenda of the Washington consensus under the disguise of such idealistic goals as poverty alleviation and peace building.

## 2. Issues of Model Law

Despite the remaining influence of model laws in the contemporary law-making scene, not many academic works have been directed to its critical analysis. Even though we find numbers of debates on the justification of model laws and the strategy of how to promote them, we rarely encounter critical analyses on the substance of these model laws.<sup>5</sup>

Among the works on the justification of model laws, economic debates on the efficacy of financial law have attracted our eyes. There is a group of authors who contend that “law matters” in promoting financial growth in the market imperfection, either in the context of avoiding adverse selection and moral hazards in the prevalence of “information asymmetry” (Stiglitz and Weiss 1981, etc.), or in the context of reducing “agency costs” against the expropriation of outside investors by those who manipulate control rights (Hart and Moore 1994; 1998, etc.). On the other hand, an alternative view argues that “law does not matter” since the market actors can develop commercial customs to prevent the above problems while circumventing deficient laws and institutions with contractual methods (Easterbrook and Fischel 1991, etc.). Another theoretical view of “contractual imperfection,” however, further

complicates the debate between law or contract (Grossman and Hart 1986, etc.). Recently, a group of econometrical economists known as “LLSV” has attracted broad academic attention by a series of works drawing the conclusion of “law matters” (La Porta et al. 1997; 2000; 2007, etc.).

LLSV consists of authors close to the World Bank Institute. They are known for featuring the questions of not only whether law matters but also which law matters, while emphasizing the supreme economic results of Anglo-American law or common law origin (Djankov et al. 2003; La Porta et al. 2007). Their argument on the supremacy of Anglo-American law as an investor-friendly model has obviously created a favorable environment for the promotion of model laws which are largely influenced by American law. Apart from this political success of LLSV, however, their argument contains fundamental methodological problems that undermine their conclusion: including the inherent limitation of inappropriate application of the historical categorization of “legal origins” from the colonial period to the comparison of contemporary financial laws;<sup>6</sup> out-dated empirical data on the substance of law taken as of 1993 disregarding yearly changes afterwards; and biased choice of variables on legal designs as well as interpretation thereof with prejudice for Anglo-American law.<sup>7</sup> Nevertheless, the superiority of common law, which is the highlight of LLSV’s conclusion on “law matters,” has become independently influential in the donors’ practice beyond the academic criticisms, often coupled with the new-liberalistic assertion of private autonomy which justifies the neglect of local laws having non-common law origin as being an inferior choice.<sup>8</sup>

Lit by this notion of superiority of Anglo-American law, equally active arguments have been made on the strategies of how to promote model laws with Anglo-American origin. Although certain empirical approaches have been made in case reviews by practitioners,<sup>9</sup> more authors have been concerned in the political process of promoting model laws (Lopes-de-Silanes 2002; de la Pena 2008, etc.). There is a group of authors featuring the academic term of “legal transplant” taken from the traditional school of comparative legal studies, while emphasizing the “receptiveness” on the side of recipient governments as the precondition of successful transplants (Berkowitz et al. 2003, etc.). Limited response has, however, been made from the mainstream of comparative legal studies,<sup>10</sup> although the distorted use of the term “legal transplant” in

the political context of donor-oriented legal reforms might undermine the accumulated academic endeavors of legal comparativists in elaborating the professional techniques of recipient-oriented legal reforms in the hands of local legal elites.<sup>11</sup> While this silence from the traditional legal schools, increasing arguments are made in the political-economic approach, such as the description of international politics between the United Nations and the Bretonwoods institutions in the formation of insolvency law models (Halliday and Carruthers 2009), political games behind the introduction of secured transaction laws (de la Pena 2008) etc.

It should be noted, however, that all aforementioned works in justifying and promoting model laws commonly lack the evaluation on the substantial contents of the very models which they deal with. They never refer to the question of what particular designs in their models either promote or harm the financial access, and/or the ultimate goals of development. This article will attempt at an evaluation on the substance of model laws, with a particular focus on a case of legal reform led by international donors in Vietnam.

### 3. Structure and Method

In what follows, the focus will be on the secured transactions law with the occasional reference to the insolvency law for the issues of intersection, both of which have always been central areas in the formation of model laws by leading donor agencies.

First, Section-2 will study the detailed substance of material model laws through the comparative legal approach, which includes the “EBRD Model Law of Secured Transactions” (EBRD 1994), the “World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems” (World Bank 2001/2004) and the “ADB Baseline Model” (ADB 2002) and the “UNCITRAL Legislative Guides” (UNCITRAL 2004; 2008). References also will be made to American law, particularly the Uniform Commercial Code, Article-9 (hereinafter “UCC-9”) and the Federal Bankruptcy Code, Chapter-11, as they are the central sources of reference in the formation process of the aforementioned model laws.

Section-3 will study the detailed substance of laws and regulations in Vietnam in the areas of secured transactions and insolvency, which was formed under the strong influence of international donors, including particularly the technical assistance given

by the ADB and the IFC (International Financial Corporation) in the World Bank Group.

Section-4 will turn to the real economy in Vietnam through an empirical approach, in order to comprehend the reaction of the market actors in response to the donor-oriented legal reforms. The results of corporate survey covering fifty (50) small and medium-sized enterprises in the manufacturing sector will be considered together with the interviews of eleven (11) bankers from seven (7) branches of six (6) local commercial banks in the areas of Hanoi and Ho Chi Minh City.

Section-5 will consider the results of corporate surveys and bank interviews in order to ascertain the deviations in market practice from the contexts of written law to reflect the model laws. These deviations will be further analysed for the purpose of evaluating the impact of model laws, while considering the nature of local reaction in supplementing the weakness of borrowed model.

## **II. Substance of Model Laws**

### **1. Purpose of Secured Transactions Law**

The “EBRD Model Law of Secured Transactions” (EBRD 1994) was formed in the earliest stage of model law promotion in the early 1990s, soon after the establishment of the EBRD as the financier of investors in the transition economies. The “World Bank Principles and Guidelines for Effective Insolvency and Creditor Rights Systems” was formed in the process of post-Asian crisis legal reforms, first publicized in a form of draft (World Bank 1999) and later appeared in a completed version (World Bank 2001/2004). It contained a section particularly dealing with secured transactions, the substance of which almost corresponded with the “Baseline Model” proposed by the Asian Development Bank (ADB), also for the sake of post-Asian crisis legal reforms (ADB 2000; 2002).

Interestingly, the substance of the EBRD Model Law and the World Bank/ADB models differ from each other, although they all shared the common goal of introducing a system of non-possessory type secured transactions particularly for movable assets, such as the American UCC-9. This difference must stem from the cautious efforts of comparative lawyers made at the EBRD for the harmonization across different legal traditions.<sup>12</sup>

Such efforts for harmonization were succeeded by the United Nations Commission on International Trade Law (UNCITRAL) when the expert groups were formed in 1999 upon the call of the US government and the World Bank for the formation of formal international models of secured transactions and insolvency laws.<sup>13</sup> Even though the original intention of the US and the World Bank was as simple as the formalization of American standard as the global model, the UNCITRAL went on with highly cautious works of comparative legal studies,<sup>14</sup> which finally produced the “UNCITRAL Legislative Guide on Insolvency Law” (UNCITRAL 2004) and the “UNCITRAL Legislative Guide on Secured Transactions” (UNCITRAL 2008), containing certain deviations from the original American models.

Though American observers are often critical against the “international politics” that hinders the globalization of modern financial law, many of them are economists holding a misunderstanding that only American law has ever developed secured transactions,<sup>15</sup> lacking the knowledge on legal mechanisms and case laws in civil law countries enabling sophisticated financial practices involving secured transactions on movable assets.<sup>16</sup> Such an indifference to foreign laws would hinder objective analyses on the weaknesses of one’s own law. In order to avoid prejudice, we need a comparative approach to the detailed substance of relevant models.

## 2. Similarities of Model Laws

### (1) Goal: Expanding Collaterals for Non-possessory type Security Interests

All aforementioned model laws commonly intend to expand the categories of collaterals that are available for non-possessory type security interests. Where the lender seeks secured lending, but the borrower has no other assets than what he uses for his very own business, the law is expected to provide for non-possessory type security interests that allow the continued usage of collateral by the borrower throughout the lending. Particularly, such expansion of non-possessory type security interests is considered necessary for the purposes of increasing financial access of small-medium-sized enterprises (SME),<sup>17</sup> and, on the other hand, enabling such sophisticated international financial practices as the project finance (PF) for large infrastructure development through the creation of security interests over entire business assets including cash flows, as well as various sophisticated transactions of

structured financial commodities through techniques of re-financing.<sup>18</sup>

However, this goal of expanded non-possessory type security interests does not always mean a simple conversion to the American model. English law has a long tradition of floating charge. In the civil law countries as well,<sup>19</sup> contemporary laws have developed flexible systems enabling expanded reach of hypothec to the identifiable type of movables (e.g. automobiles, ships, aircrafts, and machines) as well as to the foundations inclusive of various listed movables (e.g. machinery foundations, factory foundations, and railway foundations). Even for the unidentifiable or floating type of movables (such as inventories and account receivables), case law has developed to validate the commercial practice of fiduciary transfers for security purposes. The EBRD Model Law was an attempt of a comparative approach to these different traditions for achieving the common goal.

## (2) Registry: Notice-filing

All aforementioned model laws commonly propose the introduction of a simple type of registration system for secured transactions, basically learned from the UCC-9. The target of filing is a simple “notice” as a warning on the existence of security interest. There is no need for the borrower and the lender to disclose the detailed information of contracts, hence the purpose of the registry is in the perfection of priority of security interests, and not in the publication of information, which should be otherwise obtained by the efforts of related parties themselves.

## 3. Differences of Model Laws

### (1) Maximum Limits to Future Debts vs. Blanket-type

Although all the aforementioned model laws commonly provide for a flexible reach of secured debts, allowing a general coverage of “future debts,” which enables blanket type security interests for the purpose of long-term lending to flexibly meet the borrower’s occasional business needs. However, the EBRD Model Law requires a specification of future debts (section 4.4) as well as the identification of the maximum amount of such debts to be secured by the collateral (section 4.5). This is for the purpose of allowing chances for succeeding creditors and hence for the increased financial access for borrowers. The UNCITRAL Legislative Guide for Secured

Transactions (Recommendation-14; 57) similarly recommends for the specification of, and the identification of the maximum amount for, the future debts.

On the other hand, the World Bank and the ADB models never mention these limitations to future assets, while allowing unspecified blanket type security interests, as the UCC-9 does. Though this choice of legal design may be beneficial for the sophisticated techniques of refinancing based on an abstract assumption of the absolute nature of secured interest, it has a risk of hindering the financial access of SMEs to borrow from succeeding lenders, and of bringing about an overly exclusive relationship between a borrower and a lender, as an impediment to the healthy financial competition.<sup>20</sup>

## (2) Absolute Priority of Registered Secured Credits

As for the legal effect of the registration of secured interests, the question will occur whether the registered secured rights should acquire an absolute priority over any other parties' rights. A typical questionable situation is SME financing where the registered security interest of a banker, as capital investment financier, stands against the various rights of business counterparts of the borrower, usually providing operational financing for each other in the ordinary course of supply chains (either for production or for sales) on a credit basis. Since both the operational financing and capital financing are crucial for SMEs, this is a situation where law-makers require careful policy balancing.

First, in regards to transactions with the upstream of a business chain, the banker's registered blanket type security interest on unspecified movables, such as inventories, can compete with the rights of sellers on a credit basis of individual assets to be comingled with such inventories. Second, in the ordinary course of business, the borrower assumes various payment obligations to special creditors, such as wages for workers, tax payments, and social insurance premiums, which are often treated with special preference by the law and can compete with the registered secured interest. Third, in regards to transactions with the downstream of a business chain, the banker's registered security interest can compete with the buyers in the ordinary course of business of individual assets comingled in the inventories, as well as the "proceeds" out of such transactions.

The EBRD Model Law (section 17.7) provides for policy consideration to admit automatic priority to the sellers' six months purchase money security interests and to the rights of retention, without asking any additional action such as the succeeding registration as provided in the UCC-9. As for the priority question of other kinds of preferential rights, the EBRD Model Law is silent while leaving the question to the policy decision by each state. This balancing approach of the EBRD is in direct contrast to the stance of the World Bank and the ADB models which require the succeeding registration as a condition to perfect the purchase money security interests, and deny the need of preferential treatment for the special credits while emphasizing the "fair and reasonable results for the business circle."<sup>21</sup> On the other hand, the UNCITRAL Legislative Guide seems compromising here, while leaving the issue of purchase money security interests to the general rules on retention of titles and fiduciary transfers (Chapter IX), and calling for policy consideration by each state on the issue of preferential credits except for rights of retention (Recommendation 83-85).

As for the issues of transactions with the downstream of a business chain, the EBRD Model Law (section 19; 21.2.1) introduced a unique "licensing" system as a means of policy balancing: namely, the "legal licensing" or an implied approval by the registered secured party, allowing the freedom of borrower's sales of inventories to the buyers in the ordinary course of business without any further conditions. It also provided the "contractual license" to the borrower in transactions other than with the buyers in the ordinary course of business (section 20; 21.2.3), as well as various exceptions for small credit transactions, negotiable instruments, etc. in a balance with the policy need of protecting transactions of movables (section 21.2.5-7).<sup>22</sup>

On the other hand, the World Bank and the ADB models simply follow the stance of the UCC-9 in maximizing the chance of pursuits of the registered secured credit against the third parties except for the buyers who have paid without knowledge (*bona fide* purchasers) in the ordinary course of business, while ensuring the full reach of registered security interest over the "proceeds."<sup>23</sup> On the other hand, the UNCITRAL Legislative Guide shows a compromise again, assuming the basic stances of the UCC-9 on the prevalence of registered secured credits except for the *bona fide* purchasers in the ordinary course of business (Recommendation 70; 81) while

incorporating a system of “license” that implies the influence of the EBRD Model Law (Recommendation 80). It also creates certain exceptions (Recommendation 40) to the UCC-9 style principle of the broad reach of registered security interests over proceeds (Recommendation 19; 39).

### (3) Enforcement: Public vs. Private

The systems of civil enforcement differ largely between the common law and the civil law traditions. The common law tradition has admitted the freedom of private enforcement through repossession of collateral by self help and free choice between private sales and absolute foreclosure. On the other hand, while the civil law tradition has developed an efficient system of public enforcement to ensure fairness and certainty, there is a stream of criticism that developing countries following this civil law tradition of public enforcement often lack the efficiency to meet business needs (Fleisig 2000, etc.). Accordingly, all the aforementioned model laws recommend for the strengthened freedom of private enforcement. However, there are certain meaningful differences in their detailed designs.

The EBRD Model Law (section 22-28) provided for a uniquely compromised system between public and private enforcements. In order to balance the interests of registered secured parties, the borrower, succeeding lenders, and any other third parties, the Model laws required the enforcement notice to be registered before the start of the whole procedure (section 22.2), provided for grace periods for settling objections by various parties (section 24.1; 28.1), restrained self helps in repossession of collaterals (section 27), prohibited the absolute foreclosure and forfeiture contracts (section 24.2), obliged the repayment of residues to the borrower (section 28.3.6), and provided for compensation to be made by the registered secured party (section 30, etc.).

In contrast to this cautious balancing, the World Bank and ADB models simply follow the common law tradition of private enforcement, allowing the repossession by self help, ensuring free choice of enforcement methods except for certain limitation to the forfeiture contracts, and admitting final effect to the results of private sales without providing for a dispute settlement.<sup>24</sup> This pro-common law outlook of the World Bank and the ADB is, actually, even more in favor for the registered secured

party than the UCC-9 which shows certain policy balancing such as the conditions of self help, requirement of the notice to the other parties, limitation to the absolute foreclosure for the purpose of consumer protections, burden shifts to the registered secured party in the damage claims, etc..

On the other hand, the UNCITRAL Legislative Model is closer here to the EBRD Model Law, incorporating layers of judicial supervisions and other protective mechanisms for the protection of the borrower and third parties throughout the process of repossession and foreclosure (Recommendation 136-8, 141, 147-51).

#### (4) Priority in the Insolvency Procedure

The World Bank and the ADB models are known for their highly protective approach to the debtors in insolvency, adopted from the Chapter-11 of the US Federal Bankruptcy Code which features unique procedural frameworks, such as automatic stay, debtor-in-possession, classification of creditors, and the cram-down clause, for realizing the compromise of secured creditors for the sake of debtor's rescue. This pro-debtor design of insolvency law has been supported by those American scholars who emphasize the re-distributive role of insolvency procedures in protecting entrepreneurship and employment (Warren 1993; Stiglitz 2001, etc.), and by the theorists who insist that private bargaining will realize the most efficient outcomes (Jackson and Scott 1989, etc.), although criticisms have been directed at these assertions with a variety of evidence showing distorted outcomes of Chapter-11 that lacks re-distribution effects while unreasonably hindering secured creditors' interests and causing moral hazards of debtor's existing managers (Easterbrook 1990, etc.).

Another debate of whether secured creditors can truly exercise the monitoring role over corporate management to avoid the agency problem (Modigliani and Miller 1958; Roe 2000, etc.) is also relevant to the design of Chapter-11. A recently influential view denies this secured creditors' monitoring role as the justification for admitting priority to such creditors in the insolvency process (Kanda and Levmore 1994; Bebchuk and Fried 1996, etc.). This negative view on the secured creditor's role was also emphasized in the debates on the cause of the Asian currency crisis (Krugman 1998; UNDP 1999, etc.), which led to the series of pro-debtor insolvency law reforms in the crisis-hit countries (Kaneko 2008).

It seems that the model laws designed after the American law have assumed the contradictions held in the American law as well. As a result of the aforementioned unsettled debates on the treatment of secured creditors in the American law, the model laws made in the hands of these leading international donors have incorporated a contradiction of admitting the upmost priority for the registered secured creditors in the secured transaction law model and denying such priority in the insolvency law model. A more cautious approach should have been taken to balance the delicate policy considerations in both law areas before the circulation of these influential model laws.<sup>25</sup>

### III. Legal Reforms led by Model Law in Vietnam

#### 1. Secured Transactions Law as an Exception

This section will observe a case of donor-led legal reforms in Vietnam which has been a direct result of model laws. Namely, the ADB's conditionality to the financial sector reform loan obliged the government of Vietnam to introduce a new system for secured transactions, and relevant technical assistance has been provided by the ADB.<sup>26</sup>

Interestingly, Vietnam responded to this conditionality with a curious approach of legal reform creating an exception to the code system. Indeed, Vietnam follows the civil law tradition in the sense that it has introduced a civil code (first adopted in 1995, and then in 2005) as the fundamental law to constitute the foundation of civil and commercial transactions in the market reform era (Doi-Moi). Its chapter on the civil obligation and contracts (part 3) provides for the basic rules of secured lending, reflecting the structure of French code. When the ADB obliged the introduction of a new UCC-9 style secured transactions law, however, the government of Vietnam did not touch on the basic provisions in the civil code, but instead introduced a series of administrative regulations which added exceptional rules to the civil code to the extent that the code's provisions for a general blanket might allow. Namely, Decree No.165/ND-CP and Decree No.178/1999/ND-CP on the secured transactions appeared in 1999 and were valid until superseded by Decree No.163/ND-CP in 2006, together with Decree No.8 in 2000 on registration of secured credits and its subsidiary regulations, which was recently superseded by Decree No. 83/2010/ND-CP in 2010.

A question arises whether such juxtaposed provisions of the civil code and the administrative regulations can conform to each other.<sup>27</sup>

The civil code of Vietnam (art.318, sec.1) provides for the possessory type security interest or pledge (*cam co thai san*) for movable assets, and the non-possessory type security interest or hypothec (*the chap thai san*) for immovable. Although this dualistic approach to movables and immovable seems outdated, the code at the same time provides for a flexible chance of admitting additional types of security interests (art.318, sec.2), as a result of French style approach to treat security interests in the provisions on contracts, different from the German approach with a strictly closed list of secured interests as rights *in rem*. In correspondence to this flexible blanket clause, Decree No.163/2006/ND-CP on secured transactions (art.12) provides for the targets of registration of hypothec as reaching not only to immovable such as land use rights but also such specific movables as airplanes and ships, and to any collaterals on which multiple security interests are created, while putting another blanket clause referring to the chance of additional security interests.

A series of administrative regulations including Circulars No.6/2006 TT-BTP further provide for certain important details of the registration for secured transactions managed at a special center established under the Ministry of Justice. According to Circular No.6/2006 (art.2.1, a) explicitly provides for the non-possessory type security interests to be created even over unspecific or intangible types of assets, capable of covering also the future debts without requiring any identification or maximum limit. It also adds to the list of collaterals made available for the registration, which includes not only such specific types of movables as automobiles, fishery ships and machineries, but also such unspecific types of collaterals as parts, consumer products, etc. with another inclusion of a blanket clause (art.2.2).

In sum, Vietnamese legal reform took a unique structure to enable a UCC-9 like system of secured transactions with a lower level administrative circular, as an exception to the upper level administrative decree, which in itself was an exception to the basic regime of civil code. This approach might have enabled an urgent response to the pressure of conditionalities imposed by donors, while so far successfully maintaining a logical formality of the legal system. However, such a formality does not always assure a substantive conformity of the legal contents.

## 2. Substance of the Secured Transactions Law

### (1) Blanket-type Security Interest

As aforementioned, administrative regulations in Vietnam enables the blanket-type security interest over any assets of the borrower to cover unspecified future debts, without requiring any identification of a maximum amount, which follows the UCC-9. The author confirmed this practice of registration as of December 2010 in an interview with high ranking officials at the Center for Registration of Secured Transactions under the Ministry of Justice of Vietnam, and checked the registration form without slight mention to the identification or maximum amount of secured debts.

However, the officers at the Center confessed that there had been debates on the reformation of the regulation on secured transactions, particularly for the purpose of avoiding an adverse effect to the succeeding lending as well as the unhealthy exclusive relation between the borrower and the lender.

### (2) Complicated Priority Rules

Perhaps, the aforementioned blanket-type security interest would not be a problem as far as the rule of priority is based on a proper policy balance. However, problems occur since the Vietnamese law has provided for a complicated set of priority rules for the registered security interest, which can cause confusion.

First, as for the upstream transactions in the ordinary course of business, Decree No.163/2006 (art.13) copies the UCC-9's approach by providing that the sellers on credit base or on installment payments and the lesser of long-term lease can enjoy priority over the registered security interest only when completing the succeeding registration for such transactions within 15 days. As for the preferential rights regarding wages, social insurance, taxation, etc., although the UCC-9 leaves this policy balance to the freehand of statutory design in each state, the Vietnamese law is silent in both the civil code and the administrative regulations on secured transactions, which corresponds to the stance of the World Bank and the ADB models in the attempt to maximize the priority of registered security interests.

As for the downstream transactions in the ordinary course of business, Decree No.163/2006 (art.20) provides for a set of confused rules of priority. It says that any disposition of collateral outside of the ordinary course of business, when made without

“consent” of the registered secured party, unless made before the registration and to the bona fide purchasers, cannot be free of the registered secured interest (sec.1) and the proceeds out of such transaction is as well (sec.2). It also reconfirms that the dispositions made in the ordinary course of business, or made outside of the ordinary course of business with “consent,” can be free from the registered secured interest (sec.3). In sum, among three patterns provided, the pattern of sales in the ordinary course of business, and the pattern of sales outside the ordinary course of business with consent or without knowledge can prevail against the registered secured credits, but the pattern of other sales of outside the ordinary course of business (namely, without consent or with knowledge) are subject to the priority of the registered secured interests. Although the civil code (art.348, sec.4; 349) provides for similar rules, the Decree No.163/2006 has added a complicity on the knowledge of the buyer and on the rules of proceeds. This entire design reminds us of the EBRD Model Law which provided for the systems of “legal license” for transactions in the ordinary course of business and the “contractual license” for outside the ordinary course of business. However, the officials of the center for secured transitions as of December 2010, in the author’s interview, explained that the present rules of priority in Vietnamese law is an accurate copy of the UCC-9, which implies a confused understanding of the complicated legal design even among the officials in direct charge.<sup>28</sup>

### (3) Problems of Private Enforcement

The enforcement mechanism in Vietnamese secured transactions law explicitly favors private enforcement. Decree No.163/2006 provides that the parties can freely choose among private sales, foreclosure, third party payment, and any other convenient methods (art.59), and that, even in the absence of agreement, the secured party can go for private sales as far as the collaterals are movables (art.59). The repossession by self-help is admissible as far as conforming to the law and social ethics (art.63). Only formality mandated in these private procedures is the notice, or the registration instead of notice, to the borrower and the succeeding creditors (art.61). There is no mention to procedural considerations for policy balance, even to the minimum extent as given in the UCC-9 such as limitation to foreclose on consumer

protection and the shift of burden of proof in damage claims. This extremely favorable stance of Vietnamese law for private enforcement by the registered secured party could, however, enlarge conflicts among related parties, which could ultimately harm, rather than promote, the efficiency of enforcements.

#### (4) Distortion of Priority in the Insolvency Law

The treatment of secured interest in the insolvency process is provided in the 2004 Bankruptcy Law which was the wholesale revision to the 1993 enterprise bankruptcy law. The 2004 Law is known for its extremely pro-debtor approach at the expense of the secured creditors. First, the secured creditors are prevented from filing for the insolvency procedure (art.13-17) and from participating in the negotiation for the formal insolvency procedure which is supposed to be led by the representatives of the borrower, the competent administrative agencies, and the unsecured lenders (art.71).

Nevertheless, the right of the secured creditors for preferential payment is suspended upon the filing for the effect of automatic stay (art.27, no.3), and the fate of this payment will be automatically incorporated into the negotiation for the insolvency plan although the secured creditors cannot, as aforementioned, participate into it. Even if the resulted insolvency plan might be against the substantive rights vested to the secured creditors, the court has no power to look into the substance of the insolvency plan (art.72). This entire pro-debtor design of insolvency law reminds us of the very influence of the World Bank and the ADB models discussed in the previous section.

As a result, however, the fundamental contradiction conceived in these donors' model of designing the maximum priority of registered secured interests and denying it in the insolvency procedure is also seen in the Vietnamese law. This ambivalence might cause the financial practice of secured lenders to expedite the enforcement of security interests even much earlier to the truly insolvent situation of the borrower, in order to avoid the unwilling concessions later in the insolvency procedure, which could be a serious impediment to healthy financing.

## IV. Empirical Phenomena in SME Financing

### 1. Results of Corporate Questionnaire

The author attempted empirical studies on the secured transactions in Vietnam with

a corporate questionnaire to fifty (50) small-medium-sized enterprises (SME) in the years 2008-2009, as well as interviews to eleven (11) bankers from seven (7) branches of six (6) local commercial banks in December 2010.

As for the corporate survey, the questionnaire was sent randomly to SMEs in the area of auto and electric parts manufacturing in the outskirts of Hanoi, registered at the technology training center under the agency of promotion of SMEs at the Ministry of Planning and Investment of Vietnam. The answers were obtained from 50 SMEs, consisting of 34 private enterprises, 10 state-owned enterprises, 5 cooperatives, and one Japanese invested enterprise; among which, 11 were publicly traded joint stock companies, 38 were closed companies (either in the forms of joint stock company or limited liability company), and one unlimited partnership.<sup>29</sup> Major findings from the answers sometimes went against the results of preceding research, including the positive corporate monitoring role taken by such outside parties as business counterparts and bankers, their basic favorable approach to the formal law supplemented by contractual methods, and the mutually cooperative relation between business counterparts as operational financiers and bankers as capital financiers. A detailed introduction of the results follows:

#### (1) External Monitoring by Business Counterparts and Bankers

As shown in Table-1, asked about the most influential monitors over corporate management (plural choice admissible), the most significant answer was business counterparts, and then (except for the naturally important role of the government as a controlling shareholder in state-owned enterprises), followed bankers.

This importance of outside parties in corporate monitoring has not been sufficiently discussed in the preceding researches in the area of corporate governance in Asia, where the agency problem of the expropriation of outside investors by controlling shareholders has always been the center of criticism, to which the regular prescription of increased minority shareholders' rights has always been given (Claessens et al. 1999, etc.). Although there are certain arguments on new types of governance developed even under the closed-type ownership (Suehiro 2002; Sato 2004, etc.), they often emphasize the "integration of outsiders in the internal monitoring system" such as outside directors and independent auditors. On the other hand, what the empirical

Table-1 : Influential Monitors in SME by Ownership Structure of Enterprises

	Internal Monitors				External Monitors			Government	Others
	Controlling Shareholders	Minority Shareholders	Board of Directors	Auditor	Business Counterpart	Banker	Labor Union		
State-owned (10)	8	-	-	-	5	1	1	2	2
Cooperatives (5)	2	-	-	-	3	3	1	2	2
Private/ Small (11)	2	-	-	-	9	2	2	2	5
Private/ Sole/ Medium (11)	-	-	-	-	7	4	2	3	5
Private/ JV/ Medium (11)	3	-	-	-	7	4	2	3	-
Private/ Large (1)	-	-	-	-	1	-	-	1	-
Foreign (1)	-	-	-	-	1	-	-	-	-
Total	15				33	14	8	13	14

(Source: Author)

facts obtained from the author's survey is the very role of "outside monitoring" by such external parties as business counterparts, bankers, and workers.

## (2) Supplementary Relation of Formal Law and Contracts

Asked about the basis of the monitoring of these external parties, the majority of answers (27 in total 50) referred to such contractual bases as sales contracts, loan contracts, and agreements with labor unions employment. Only a few (8 in total 50) referred to the utilization of legal bases provided in formal law, such as damage claims against directors under the Enterprise Law, as well as the utilization of minority shareholders' rights of access to corporate information after obtaining a certain share of the company.

Asked further about the choice of forum and the legal basis in case of dispute resolution with these external parties, as shown in Table-2, a tendency of respecting formal judicial process and formal law is obvious, except for the labor disputes where conciliatory dispute resolution is often sought. Particularly for private enterprises, the importance seems placed on the predictability in dispute resolution through litigations

Table-2: Choice of Dispute Resolution by Ownership Structure of Enterprises

	Choice of Legal Bases						Choice of Forum								
	Counterparts		Bankers		Labor		Counterparts			Bankers			Labor		
	Formal	Informal	Formal	Informal	Formal	Informal	L	A	C	L	A	C	L	A	C
State-owned	8	2	8	2	7	3	3	2	5	4	2	4	-	-	10
Cooperative	3	2	3	2	4	1	1	1	3	1	-	4	-	-	5
Private/Small	8	3	8	2	9	1	2	5	3	2	4	4	2	-	8
Private/ Medium	20	2	19	3	16	6	6	8	8	12	4	6	1	-	21
Private/ Large	1	-	1	-	1	-	1	-	-	1	-	-	-	-	1
Foreign	-	1	1	-	1	-	1	-	-	1	-	-	1	-	-

(Source: Author) (L: Litigation; A: Arbitration; C: Conciliation)

at the court with formal law. This is quite the opposite finding from the arguments made by preceding research emphasizing a strong circumventing practice of the Vietnamese private sector to avoid formal litigation and the application of formal law (McMillan & Woodruff 1992; 1999; Gillespie 1997; 2004; Nicholson and Nguyen 2000).

### (3) Concurrence of Secured Lending and Credit Control

The questionnaire further asked about the detailed practice of SME financing. The answers described an interesting tendency of bankers' strict credit control while showing a strong inclination of secured financing. The answers also implied a favorable relation between the bankers and the counterparts of borrower in the ordinary course of business.

First, as shown in Table-3, bankers make a practice of secured lending. As for the choice of collaterals, they do not seem hesitant to take such unspecific or intangible types of collaterals as inventories and account receivables, in addition to traditional types of assets such as lands and buildings. Another interesting aspect is a positive tendency toward the long-term, blanket type security interests, which are sometimes created for a sole bank as a holistic security interest over entire business assets of the borrower.

At the same time, the bankers are keen on credit control, while asking for four to six years of annual reports upon the decision of first lending, and keeping continuous monitoring of several times per year throughout the lending period. Although some of

Table-3: Practice of SME Financing by Ownership Structure of Enterprises

	Annual Reports (year)			Credit Monitoring (times/year)			Types of Securities					Long-term Blanket Type		Number of Lenders	
	0	1-3	4~	0	1	2~	None	Guarantee	Immovable	Tangibles	Intangibles	No	Yes	1	Many
State-owned (10)	-	2	8	-	5	4	-	1	6	4	3	5	5	9	1
Cooperative (5)	-	2	3	1	1	3	-	1	5	2	-	2	2	4	-
Private/ Small (11)	2	2	7	4	3	2	-	1	7	7	1	8	2	7	2
Private/ Medium (22)	3	7	14	4	11	7	-	-	21	15	1	10	12	20	2
Private/ Large (1)	1	-	-	1	-	-	1	-	1	1	-	-	1	1	-
Foreign (1)	1	-	-	-	1	-	-	-	-	-	-	-	-	-	-

(Source: Author)

the secured lending to small-sized private enterprises shows a tendency of weak credit control, this seems to be a result of limited credit information directly available from the borrowers of this type, rather than implying a dependency on secured interests.

These results must imply a concurrence of the positive taking of security interests, particularly for long-term lending, and strict credit control. Such a practice in the SME financing in Vietnam might imply the possibility of long-term relational lending as an important basis of the external monitoring role of bankers over the SME corporate governance. This implication is quite opposite to the concerns that have been emphasized by preceding researches since the Asian currency crisis about the dependence of Asian bankers on secured lending without sufficient endeavors of credit control, which might have formed one of the structural weaknesses that brought about “crony capitalism” (Dwor-Frecautet al. 2000 etc.).

#### (4) Favorable Relation between Bankers and Business Counterparts

Asked about the utilization of transactions on a credit basis with daily business counterparts, most of the answers were affirmative (45 in total 50), in which the rate of credit-based transactions with less than 50% constituted the majority (26 in total 45). But the number of those with more than 50% were also significant (12 in total 45), in which the small-sized private enterprises showed the largest tendency (6 in

Table-4: Relation between Capital Financing and Operational Financing (by case)

	Credit-based Transactions		
	None	1-50%	50-100%
Long-term Capital Financer (with Blanket-type security interests)	4	13	6
Short-term Capital Financer (without Blanket-type security interests)	0	13	13

(Source: Author)

total 11).

Then, what is the reaction of the bankers toward such a positive practice of credit-based transactions? As shown in Table-4, the rate of co-existence of the credit-based transactions with business counterparts and the blanket-type secured lending by bankers is significantly high (19 in total 23), provided that all cases of lending without blanket-type secured lending showed such co-existence with the credit-based daily transactions. These answers at least imply that the corporate monitoring role of bankers as capital financer goes together with the operational financing by the daily business counterparts of the borrower.

## 2. Interviews with Bankers

In order to further ascertain what has been implied in the aforementioned corporate questionnaire about the mutual relation between the enterprise, bankers as capital financer, and the business counterparts as operational financer, the author conducted interviews in December 2010 through January 2011 with a total of eleven (11) bankers in charge of corporate lending at seven (7) branches of six (6) commercial banks operating in Hanoi and Ho Chi Minh City. All these interviewees were middle class officers with three to ten years of lending experience, and answered informally in a private status with a reservation that his/her opinion did not represent any official opinion of each bank. The banks included such large state-owned commercial banks as the Vietcombank, the BIDV (investment and development bank) and the Agribank, as well as the middle-class joint stock banks such as the Military Bank, the Bao Viet Bank, and Dong A Bank. The major results are summarized as follows:

### (1) Concurrence of Secured Lending and Strict Credit Control

As shown in the corporate questionnaire, the interviews reconfirmed the concurrent practice of secured lending and strict credit controls. All answers described the established principle of secured lending based on the credit standards developed within each bank according to the regulations set by the State Bank of Vietnam (including Decision No.1627/2001). According to such standards, secured lending is always the principle, and only in exceptional cases with the highest credit evaluation, such as renowned state-owned enterprises, banks might admit lending without security interest. Therefore, larger state-owned commercial banks such as Vietcombank that transact more with renowned state-owned enterprises, showed a higher tendency of unsecured lending than middle-class banks in which the share of private SME among borrowers often counts for more than 90%.

On the other hand, all answers described a practice of highly cautious credit analyses as of the beginning stage of lending, based not only on financial information directly obtained from the SME, including annual balance sheets and profit and loss statements for more than three years as well as random checks on the charts of cash flow, but also on various side information obtained from reliable sources such as tax reports (which must reflect the severest evaluation on the corporate financial situation) and the credit information weekly and spontaneously available at the Credit Information Center (CIC) of the State Bank of Vietnam. The methods of credit control during the lending period seemed more serious, with the quarterly financial reports and the monthly to quarterly direct inspections on average.

### (2) Secured Lending in a Competitive Financial Market

As for the background of this concurrently strict practice of secured lending and credit controls, a reference should be made to the highly competitive condition in the present financial market in Vietnam. All answers emphasized that the banks had been put in a highly competitive condition in terms of lending, without any implication of the risk of exclusive or monopolistic relation between the banker and the borrower, which can create an easy lending practice of crony capitalism. On the contrary, it was implied that banks were competing hard for better collaterals in order to achieve larger outstanding loans with higher safety.

The ranking of preferred collaterals is as follows: all answers favored most of the hypothecs on the immovable such as land use rights and buildings, because of the stability of asset value and the convenience in enforcements since the banks would acquire tentative possession of the certificates of title of these immovable collaterals in preparation for possible enforcements. It is also an interesting bankers' practice that once they create a security interest on immovable, they seldom admit succeeding lenders to utilize the residue on the same collateral (by refusing to release the certificate of title under the bank's tentative possession even when asked for the sake of bringing them to the registry of succeeding secured credits), but instead maintain a monopolistic control over it, and even adhere to the same collateral for the use of roll-overs of medium-term lending repeated for every 3-5 years, thus realizing a practice of *de facto* blanket-type secured lending.

As a result of this strong preference over immovable collaterals and the inclination to monopolistic possession of their title certificates, it turns out that the succeeding lenders who lost in the competition of obtaining immovable collaterals have to reach for new types of collaterals. All answers confessed that they would first seek such tangible movables as machineries and automobiles, and they would also ask the corporate owners to provide their personal tangible assets, but that, in case of a scarcity of these tangible assets, they would go further to acquire unspecific or intangible types of assets such as inventories and account receivables. However, the management of such unspecific and floating types of assets was explained as quite tiresome, because of the complicated legal provisions in the administrative regulations on secured transaction. One banker from Dong A Bank, a middle-class private commercial bank, vividly described the toughness of such management, where each bank would have to designate an officer in charge of the collateral management for each borrower, and oblige this officer to meet daily with the representative from the accounting division of such borrower so as to check and give "consent" to the every daily change of inventories and account receivables. He added that, despite all such tiresome management of unspecific collateral, bankers would face the difficulties of enforcement in the phase of corporate insolvency, because of the difficulty of physical control over such collaterals, which caused the unpopular ranking of this type of collateral.<sup>30</sup>

According to an efficient summary given by a banker at the Military Bank, the better the credit evaluation of a borrower (e.g. large state-owned enterprises), the larger the rate of movables that bankers would accept as collaterals. This summary corresponds to the information obtained from the Vietcombank, one of the largest stated-owned commercial bank, that the rate of movables in total collateral is roughly 40%. On the other hand, according to the summary given by the same banker, the rate of movables in SME financing comes to as much as 50-70%, in which more than 30% are intangible assets such as inventories, because of the original scarcity of tangible assets.

These answers eloquently tell the reality that, because of the harsh financial competition among banks in Vietnam, bankers have had no other choice but to go forward with expanding the reach of collaterals, including those of unspecific or floating types. This financial competition also seems to have caused the practice of monopolistic taking of collateral without allowing succeeding secured credits, while resulting in the further scarcity of collateral. Anyway, as might again be a result of harsh financial competition, such a practice of monopolistic collateral taking so far has only been developed in terms of individual collateral, without creating the risk of exclusive financing based on holistic taking of entire business assets. In sum, the implication is that the more the financial competition, the more the bankers are required to take new types of collateral which necessitate stricter monitoring over daily corporate business.

### (3) Importance of Business Counterparts for Bankers

All answers emphasized the importance of business counterparts of the borrower, not only as a reliable source of information particularly indispensable for credit analysis of SMEs, but also as fundamental goodwill indispensable for a successful long-term operation of the borrower, which constitutes the very basis of the recovery of credits.

It is presumable, though not explicitly mentioned in the answers, that the business counterparts are all the more important when the banks take the long-term blanket type secured interest on unspecific, floating types of business assets, since the existence of stable business transactions constitutes the essence of this type of

collateral.

Thus, the stable relation between the borrower and its business counterparts is crucial for the bankers in every means. None of the interviewed bankers showed any hint of seeing these operating financiers as their competitors or any other problems.

#### (4) Problem of Insolvency Procedures

Many answers confessed that they seldom utilized the insolvency procedure, and that the main reason for this was that they would resort to earlier enforcements of security interests before being involved into the tiresome insolvency procedure.

As mentioned in the previous section, the present Vietnamese insolvency law provides for a highly pro-debtor design that hinders the initiative and participation by the secured lenders. Accordingly, almost all private commercial banks that, as aforementioned, make it as a principle to lend on a secured basis would reasonably hold a strong incentive for early enforcements before insolvency. A banker from the Dong A Bank, having relatively much experience in insolvency cases, emphasized the insolvency procedure as the worst problem in the area of financial law in Vietnam.

### V. Effectiveness and Impacts of Model Laws in Local Context

#### 1. Basis of Evaluation: Financial Access for SME

The secured transaction law reform in Vietnam and its outcome observed in the previous sections would provide us with a chance of evaluating the effectiveness and the impacts (both negative and positive) of donor-oriented model laws. An evaluation should need a proper basis. The author believes that a basis of evaluation for legal reform assistance should be an expected outcome in the local society receiving such assistance, rather than the goals envisaged on the side of donor agencies.

Donors in the legal reform assistance have never developed proper methods for evaluating the outcomes and the impacts of these reforms. Although most donors conduct intermediary evaluations and/or post-completion evaluations just as in the cases of other areas of development aid projects, these evaluations are usually simple cost-benefit analyses for the purpose of evaluating the “efficiency” of inputs based on their outputs, which do not reach the evaluation of “effectiveness” in achieving ultimate goals of the legal reforms. Leading donors seem even skeptical about the need

of “effectiveness” tests for legal reform assistance, while repeatedly emphasizing the difficulties of identifying the direct outcomes of legal reforms.<sup>31</sup>

Perhaps, the true difficulty in evaluating the legal reform assistance must lie in the logical gap that often exists between the level of the ultimate goals of legal reform and the level of actual inputs of assistance. This is because logical frameworks of many assistance projects are designed for introducing donor-oriented models at the level of input, which does not always correspond to the abstract ideals such as “empowerment,” “rule of law,” and “market reform” emphasized in the level of the ultimate goals. What is needed in filling this gap must be the identification of “outcomes” to bridge the idealistic goals and the actual project operation.<sup>32</sup>

In the particular case of the ADB’s assistance to the Vietnamese secured transaction law reform, the evaluation summary as of the completion revealed this type of gap between its ultimate goal of “rule-based socialist market economy” and its inputs (although in the name of “outcome”) of “building the secured transaction registry and strengthening its implementation” (ADB 2010). Though the evaluation given to the project was positive, it seemed nothing more than a cost-benefit analysis between inputs and outputs. The true question that should have been asked was whether the project effectively achieved the “outcome” that should have been identified for the sake of concretizing the abstractly expressed ultimate goal.

Then, what should have been the “outcome” to bridge the “rule based socialist market economy” and the secured transaction law reform? A logical deduction may suggest the need of legal infrastructure to increase financial access for the central actor in the socialist market economy in Vietnam. Such actors have turned out as the progress of market economic reform of “Doi Moi,” to be a large majority of small-medium-sized enterprises in the private sector. Accordingly, better financial access for SMEs is among the most plausible candidates of “outcome,”<sup>33</sup> as a basis of evaluation of effectiveness (in terms of the conformity of project outputs, namely the formal legal provision) and of impacts (in terms of socio-economic reality or deviations from the formal legal provisions) in what follows in this section.

## 2. Effectiveness of Legal Design

Basic designs of law in book for secured transactions in Vietnam such as Decree No.163/2006 and Circular No.6/2006 were the direct products of the ADB's technical assistance that introduced donor-oriented model laws. Whether such legal designs can be effective in terms of SME's financial access is the question considered here from the viewpoint of comparative law.

Its first characteristic was a broad admission of blanket-type security interest to cover unidentified secured debts without asking for specification of maximum amount. Although a blanket-type security interest may have a positive effect on the promotion of long-term lending (ADB 2002), at the same time, it can create an impediment to the succeeding lenders, and also, as harshly criticized in the post-Asian currency crisis context of "crony capitalism," can constitute a basis of an unhealthy close relation between lender and borrower lacking arm's-length distance (Dwor-Frecaut et al. 2000).

Priority rules of Vietnamese law are designed favorably for the registered security interests as capital financier, even at the expense of inventory financing where the operation capital finance is provided by business counterparts. The rules do not admit the priority of sellers of inventories on a credit basis without succeeding filings at the registry, and lacks any explicit provision on protection for other preferential rights, and only vaguely provides for the system of "consent" to daily transactions of inventories with business counterparts. Since the buying and selling of inventories, especially on a credit basis, constitutes the heart of SME operations, such legal designs of pro-capital financier can create impediments to SME financing.

As for the enforcement procedure, as a result of the extremely favorable stance of the Vietnamese law for the freedom of private enforcement, it lacks sufficiently detailed procedural rules for the balancing of interests among related parties, which, judged from numerous comparative legal episodes from developing countries (ADB 2000, etc.), can be a serious impediment to effective enforcement.

This weakness of the enforcement procedure must cause all the more problems in the process of the insolvency stage where the secured creditors are motivated for earlier enforcement in order to avoid the automatic stay that suspends the freedom of enforcement, and can ultimately deprive their preferential rights without allowing

participation in decision-making. This overly pro-debtor design was another product of donor-oriented model law, which, judged from such comparative legal episodes as the cumulative cases of abuse in the U.S. Federal Bankruptcy Code Chapter-11 since 1986 (Jackson et al. 1989, etc.) and the French bankers' informal practice to avoid the 1985 insolvency law (See Ancel 2008), may harm the reasonable bargain among related parties.

In sum, viewed on the structure of legal designs in book, Vietnamese law as the result of donor-oriented models is inclusive of not a few weaknesses that could harm SME financing.

### 3. Impacts in the Implementation

What impacts either for or against SME financing have been caused by the aforementioned weaknesses of the legal designs, and how are such impacts being overcome through supplements to and/or circumference of the formal law, are the questions considered here based mainly on the sociological facts obtained from the results of the author's surveys discussed in section 4 above as well as of other empirical researches.

#### (1) Supplementary Financial Practices as a Result of Financial Competition

As for the aforementioned risk of the legal design of blanket-type security interests to enhance monopolistic control over collaterals and hence to create an overly closed relation between the capital financier and its borrower, the result of the corporate questionnaire and bankers' interviews, as mentioned in section-4, actually revealed a strong inclination of Vietnamese banks to favor a first-place and holistic control over collateral so as to secure convenience for enforcements. However, interestingly, this practice of monopolistic taking of collateral does not always lead to a financial impediment to hinder succeeding lenders, since such a practice of holistic control over collateral is taking place only in terms of individual collateral, and never seems to lead to a creation of holistic control over the total business assets of the borrower. This seems to be a result of active competition among banks for taking better collaterals, which is a phenomenon that represents a highly competitive condition of the financial market, and also partially resulted from the strict principle of secured lending established by the regulation of the State Bank of Vietnam.

In sum, given the highly competitive condition in the domestic economy, the inherent risk of closed financial relations held in the original legal design of blanket-type security interests has so far been circumvented by the actual financial practice, while bringing about such beneficial side effects as long-term financial relations and broader reach to new types of collaterals. Once a competitive financial market is lost, however, such beneficial impacts will also be lost.

## (2) Daily Monitoring Practice of Banks

As for the risk of financial impediments, particularly for operational financing between daily business counterparts, of the present priority rules overly beneficial for registered secured parties as capital financier, actors in the real economy in Vietnam seem to show positive efforts to supplement for this weakness of the priority rules. Namely, the majority of SMEs answered as discussed in the aforementioned questionnaire in section-4 that they enjoy operational finance with business counterparts even though they at the same time borrowed from bankers with security interests over their daily changing inventories and/or account receivables. In order to allow this concurrence of operational finance and capital finance on the same floating collateral, enormous efforts has been made by both the borrower and the banker.

Namely, bankers' interviews in section-4 identified enormous efforts made daily by bank officers to check and give consents to every detail of changes of inventories and account receivables which collectively constitute the collateral of their lending. Only through such tiresome work can concurrently realize both the strict maintenance of secured credits and the continued business operation of the borrower, since the overly pro-banker priority rules cannot otherwise ensure the validity of credit-based transactions of the borrower.

While interviewed bankers from larger state-owned banks showed a strong dislike toward utilizing such a tiresome type of secured lending, medium-class private banks seem to have no other choice but taking the daily management of such floating types of collaterals, particularly because the majority of their customers are private SMEs which often lack a sufficient amount of tangible collateral. These empirical findings must strongly imply that the present legal design on priority rules has a negative impact on SME financing, which is partially mitigated by the serious efforts of

medium-class banks, and might be creating a positive side-effect of increased depth of corporate monitoring by such banks.

### (3) Ambivalent Enforcement and Insolvency Procedures

It can be seen from the bankers' interviews that the present *laissez-faire* style of legal design excessively favors for private enforcements and is, as opposed to the expectation of donor-oriented models, actually harmful to the efficient enforcement of security interests. Although the law admits the freedom of self-help, the bankers are experiencing enormous difficulties in real practice because there is no judicial procedure provided in the law, other than the occasional intervention by the local police, which they can depend on in tackling every possible protest that the borrowers attempt in hindrance to the enforcement.

In order to supplement such weakness of the present legal designs, most of the bankers depend on a primitive financial practice to physically occupy the possession of title certificates on collaterals. This need for physical control of collateral, because of the weakness of enforcement procedures, seems to be the very reason of the aforementioned practice of monopolization of collateral which is an impediment to the succeeding lenders on the same collateral.

On the other hand, the overly pro-debtor design of the insolvency procedure is, on the contrary, creating the bankers' motivation for early enforcement which is killing the possible chance of reorganization of SMEs. This is a serious impediment to SME financing. This impediment cannot be justified by the often made argument that the secured lenders are not always the best corporate monitor and therefore lack reason to be treated with priority (Kanda and Levmore, 1994, etc.), because the corporate questionnaire and bankers' interviews in this study have identified an explicit fact that Vietnamese banks as secured lenders are seriously taking the role of external monitor in the SME financing.

## VI. Summary and Proposal for Asian-style Face-to-Face Finance

Taking the case of donor-oriented legal reforms in Vietnam, and based on the expected outcome in the local context of economic reform called "Doi Moi", this article has identified certain weaknesses of donor-oriented model laws, in terms of the

“effectiveness” of legal designs as direct outputs of donor assistance, and of the “impacts” caused in the local socioeconomic reality as a result of such outputs. Such a finding of weaknesses must have a negative implication to the donors’ decisive promotion of “legal transplants,” or the view of “law matters” creating the pressure of legal reforms in developing and transition countries based on so-called global standards.

At the same time, however, this article also identified interesting reactions on the side of local economic actors who are making efforts to circumvent or supplement for overcoming such weaknesses of given legal designs, such as avoiding the risk of closed lending practices by competitive taking of collaterals while depending on the basic legal design of blanket-type secured interest, making enormous efforts of daily monitoring on the borrower’s floating assets for the sake of allowing the transactions in the ordinary course of business while ensuring security interests, and developing self-protective measures such as physical possession of title certificates in order to mitigate the weakness of private enforcements.

It is important to recognize that these informal financial practices are held concurrently with a strong pro-formal law attitude of market actors, as explicitly shown in the results of the corporate questionnaire and bankers’ interviews. Particularly, all interviewed bankers were keen on understanding the details of formal law which is quite frequently changing according to the rapid pace of “Doi Moi,” representing a strong mind held among ordinary economic actors seeking to be protected by law.

It should be understood that, in circumventing and/or supplementing the weaknesses of the formal designs of law, these market actors are far from neglecting the formal law for the sake of private autonomy, but instead, bridging their economic needs with the formal law. Such a basic pro-formal law mind of economic actors in Vietnam should be an evidence against the view of “law does not matter” to the discouraging for the local law-making efforts.

An idealistic legal reform must be something that encourages local initiatives in bridging the real economic needs and formal law. In the particular field of secured transactions law, as an example, locally developed informal financial practices reveal the needs for a better priority rule enabling policy balance between various parties,

including that between capital financiers and operational financiers, and a public enforcement procedure that can achieve a procedural fairness acceptable for every related party including the borrower himself, and others. When these actual economic needs are reflected in the process of formal law-making, instead of automatic transplantation of donor-oriented global models, we might be able to observe an emergence of “Asian-style” financial law, or a face-to-face type financing in which bankers can closely monitor the borrowers while living in the tension of a competitive market.

In contrast to the fate of transition economies in Europe which have gone through with the transplant of donor-oriented financial law models only to be affected by the World Financial Crisis in 2008, Asian financial sectors have been doing well probably because of their limited obedience to the same donor models as have incorporated these European emerging economies into worldwide sophisticated linkages of refinancing.<sup>34</sup> When an arm’s-length relation of financing is firmly maintained in Asia, and meets with proper prudential policies of the central bank watching over financial competition (instead of a dependence on deregulated model of competition law), we will be able to foresee the cease of a vicious cycle of pro-debtor insolvency law backed by governmental rescues only to create moral hazards in the private sector that leads to repeated financial crises.

## Notes

- 1 Among major areas of model laws, there are secured transactions law (*see* EBRD 1994; ADB 2002; UNCITRAL 2008, etc.), insolvency law (*see* World Bank 1999; 2001/2004; IMF 1999b; ADB 2000; UNCITRAL 2004), corporate governance (*see* OECD 1999/2004; OECD 2003; EBRD 2000a; World Bank 2003), and competition law (World Bank/OECD 1999; UNCTAD 2004, etc.).
- 2 Among typical cases of law-making compelled by loan conditionalities, there are legal reforms led by the emergency rescue packages of the IMF and World Bank after the Asian currency crisis. *See* Kaneko (2009) for the details.
- 3 Among typical examples of indicator surveys applied in combination with model laws, there are the “Legal Indicators Survey” by the European Bank for Reconstruction and Development (EBRD), and the “ROSC (Reports on the Observation of Standards and Codes)” by the World Bank and IMF.
- 4 For details of log-frames of donors, *see* the introduction of Kaneko (2011).
- 5 *See* Kaneko (2008) and (2009) for an almost sole attempt in the Japanese writing about the substance and consequence of financial model laws introduced in the post-Asian crisis nations.
- 6 For example, the LLSV treats the English law and the American law in a single group of

- “common law origin,” although, particularly in the area of financial law where the LLSV focuses on, the difference between these two jurisdictions is enormous. Equally problematic is their general inclusion of Central and South American countries into the French law origin, although their recent financial law has largely been under the influence of American law.
- 7 For example, Lopez-de-Silanes (2008) in drawing his pro-common law conclusion in terms of effective control of asymmetric information and agency costs, his choice of variables (e.g. absolute priority of secured lenders; jury trial and limited appellant review; freedom of private enforcements) contains strong pro-common law bias. Also, his stance in interpreting empirical data shows certain bias (e.g. disregarding the pro-civil law results on asymmetric information as “not significant,” while emphasizing the pro-common law result on agency costs although deviation values are similar.
  - 8 *See e.g.*, Lopez-de-Silanes (2008) p.39.
  - 9 *See*, for the reviews of cases of introduction of secured transactions law models in the transition and developing economies, the series of reports at the Center for the Economic Analysis of Law (Fleisig 1999; 2006; 2008; Fleisig et al. 2006, etc.), as well as the review of cases at the EBRD (EBRD 2000; Dahan and Simpson 2008, etc.).
  - 10 It was a disappointment that the special session of “Legal Culture and Legal Transplant” at the 18th International Congress of Comparative Law in Washington, D.C. (July, 2010) saw few substantial discussion on the problems of contemporary legal transplants taking place in worldwide. Professor C. Zimmermann in his chairmanship summary ended up with the issue of how to make legal transplants successful.
  - 11 *See* Watson (1974/1993) for the original concept of “legal transplants.”
  - 12 *See* the preamble of EBRD (1994) summarizing the efforts in its preparatory process led by lawyers from various jurisdictions including the UK and Germany.
  - 13 *See* ‘Introduction’ (sec.A-4 etc.) of UNCITRAL Legislative Model on Secured Transactions as well as the UN General Assembly Resolution No. 63/121 dated December 11, 2008.
  - 14 The expert group for insolvency law consisted of 36 member states, which continued deliberations for five years in a total of seven sessions, the result of which was finally approved by the UNCITRAL in June 2004, and approved by the UN General Assembly at the year-end 2004 (Resolution No. 59/40). Similarly, the expert group for secured transactions involved 60 member states, who met for twelve sessions during the years 2002-2007, the result of which was approved by the UNCITRAL in December 2007, and finally recognized by the UN General Assembly in December 2008 (Resolution No.63/121).
  - 15 *See e.g.*, Daham and Simpson (2008) p. ix; de la Pena (2008) p.254-255.
  - 16 According to the author’s observation, the lectures on secured transactions at law schools in the U.S. do not teach comparative knowledge on foreign systems, resulting in a belief among students that American law is the sole model. Civil law countries have actually developed special systems of hypothec since early 20<sup>th</sup> century, not only on such specific movables as ships and automobiles, but also on consolidated sets of movables as a foundation, such as a factory foundation and a railway foundation, and accumulated case laws on the retention of ownership and the fiduciary transfers, which often been incorporated into the formal law as in the case of French civil code amendment in 2006. These facts of legal development should be comparable with common law developments such as formation of commercial customs on floating charge in British law as well as the development of UCC-9 in the US since 1951.
  - 17 *See e.g.*, ADB (2000) ‘Preface’ A-2, A-5, A-6; UNCITRAL (2008) ‘Introduction’ A-2.
  - 18 *See e.g.*, EBRD (1994) ‘Introduction’; World Bank (1999) section 5.1; ADB (2000) ‘Preface’ A-5.
  - 19 By the early 20th century, many civil codes allowed the non-possessory type security interest (or hypothec) only for immovable assets (such as lands and buildings), while

- admitting only the possessory type security interest (or pledge) for movable assets. This separation of immovable and movables used to be considered necessary, as the civil codes provided for the basic principle of immediate transfer of ownership on movable assets as of the transfer of possession, so as to protect the trusts among market actors in the transaction of movable assets which are by nature movable. Modern law, therefore, is expected to balance both policy needs of protecting the trusts in transactions of, and of expanding the non-possessory type security interests on, movables.
- 20 In the debates on causes and cures of the Asian currency crisis in the late 1990s, criticisms were made on the “crony capitalism” that lacked the “arm-length” relation between the borrowers and the lenders in the financing in pre-crisis periods. See Dwor-Frecaut et al. (2000).
- 21 See World Bank (1999) section 5.2 (9); ADB (2000) section-83.
- 22 This balancing stance of the EBRD Model Law reminds us of the “implied license theory” developed in the Canadian case law prior to the introduction of the American style secured transaction law at the expense of the financial practice based on the English floating charge.
- 23 See ADB (2000) section 85; 101.
- 24 See World Bank (1999) section 5.2 (7); ADB (2000) section 101; 505; 511.
- 25 Lessons should have been learned from the results of comparative legal studies, such as the experience of French law where the overly pro-debtor stance of the 1985 insolvency law has encouraged a financial custom to avoid formal law through the informal development of ownership-based security interests (fiduciary transfers and retentions of titles). See Ancel 2008.
- 26 There is the ADB/TA 2823-VIE (for the years 1997-2001) and ADB/TA 4060-VIE (for the years 2003-2009).
- 27 A reference should be made to the style of French legal reform in 2006, where the legislature entrusted the administrative decrees to detail the design of the new system of secured transactions, but they were finally incorporated into the civil code.
- 28 Although the reference to the knowledge of buyers and the rules on proceeds implies influence from the UCC-9, Vietnamese law admits the full legal license to any buyers in the ordinary course of business, which is different from the UCC-9 which only allows for the prevalence of bona fide purchasers in the ordinary course of business.
- 29 According to the brief description of corporate history obtained from each enterprise, there is an evident trend that private enterprises are usually in favor of the form of closed company, with a certain inclination of the strong control by majority shareholders (22 among total 33). On the other hand, state-owned enterprises usually start with the form of closed company but show a strong tendency to go public. The same tendency for ultimately going public is to a certain extent observed for cooperatives.
- 30 It seems that the more a banker has experienced insolvency cases, the more he/she knows the limitation of such secured interests on unspecific or floating assets. This banker from Dong A Bank described the desperate attitudes of borrowers who utilize all means to hinder the banks’ recovery. Bankers from the Agribank were also pessimistic about the ultimate securing effect of floating assets. A banker from the Military Bank expressed her opinion that revision of legal regulation must be necessary in order to increase the enforceability of these floating types of collateral.
- 31 See e.g., World Bank (2008).
- 32 See for the discussion on the methodology of evaluation for legal technical assistance from Japan, ICD-MOJJ (International Cooperation Department of Ministry of Justice of Japan) (2011).
- 33 For example, the need of SME financial access was a central pillar in the “SME

Development Plan 2006-2010” issued in 2006 by the Ministry of Planning and Investment of Vietnam (Agency for SME Development: ASMED) based on the technical assistance provided by the ADB.

- 34 Despite the post-Asian crisis conditionalities of the donor agencies strictly obliged the crisis-hit countries to transplant the secured transaction law, Thailand suspended the draft of such law at the cabinet, Indonesia enacted a law in 1999 but with a modification to the priority rules based on certain policy consideration, and other countries, including Cambodia and Laos, that once introduced the legal reform did not see any implementation by the real economic sector.

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