

Colombia's New Law on Security Interest over Movable Assets Comes Into Effect

On February 21, 2014, a new law on security interests over movable assets (Law 1676 of 2013,¹ "Law 1676") came into effect in Colombia. Law 1676 replaced the regulations on creation, perfection and enforceability (*oponibilidad*) of security interests over movable assets set forth in the Code of Commerce of Colombia of 1971 (the "Code of Commerce"). The purpose of Law 1676 is to increase access to the financial products of medium and small-sized companies ("PYMES").² It accomplishes this by reducing the time, procedures and cost needed to perfect and enforce security interests and by expanding the types of assets that can be subject to a security interest.³ Despite this limited purpose, the application of Law 1676 promises to be far reaching and will impact not only security interests created by PYMES, but also the way all security interests over movable assets are perfected, monitored and enforced in Colombia.

Among the most significant changes in the new law are: (i) an expansion of the types of assets that may be subject to a security interest; (ii) the creation of a new centralized system where filing and searches of security interests may be conducted; (iii) new methods to enforce security interests against third parties; and (iv) new methods to enforce security interests against debtors/guarantors.

Assets that May Be Subject To Security Interests

Law 1676 expands the types of assets that may be subject to a security interest by establishing that the proceeds or the products that result from the transformation, sale or substitution of collateral may be subject to a security interest. This new feature is a significant departure from the traditional concept of security interest under Colombian law (and civil law generally), which only covers the specific asset named in the security agreement, and follows the pattern of more dynamic laws, including the Uniform Commercial Code and the guidelines promoted by the UNCITRAL. The new system also eliminates the burden imposed on creditors and debtors on having to create, perfect and register a security interest each time an asset is sold, transformed or substituted.

Law 1676 also introduces the concept of a purchase money security interest (*garantía mobiliaria prioritaria de adquisición*) ("PMSI"). Pursuant to Law 1676, a PMSI is a security interest in goods that secures the repayment of the debt owed in connection with the purchase price of such goods. Under the new law, once filed, a PMSI is awarded a super-priority treatment vis-à-vis other security interests created over the goods sold. This feature will likely foster lending and selling on credit, as it will help mitigate the credit risks of customers that have financed their purchases of such goods by allowing the creditor/seller to regain

possession of the goods sold should the customer default in the payment of the goods.

Innovative Filing and Monitoring Process

Prior to Law 1676, a security interest over movable assets was enforceable against third parties once the relevant security agreement was registered with the Chamber of Commerce (*Cámara de Comercio*) where the collateral was located. This fragmented registration system was cumbersome, as it required creditors to constantly monitor the location of assets and forced debtors to carry on deregistration and registration procedures each time an asset was moved to another jurisdiction.

Law 1676 simplifies the process of enforceability (*oponibilidad*) of a security interest against third parties by creating a national movable assets public registry administered by the National Association of Chambers of Commerce (*Confederación Colombiana de Cámaras de Comercio—Confecámaras*). Pursuant to the new law, all security interest filings may be made, modified, extended, cancelled, transferred and searched in the new national centralized system. Law 1676 also allows for the filing of electronic registration statements (*formularios de registro*); this simplifies the filing steps and reduces the length of the review process that needed to be completed for filings under the prior system.

Another important feature of Law 1676 is that it allows any person to access online the centralized registry to search for assets that are subject to a security interest, determine the value of the secured obligation and confirm the status of the underlying assets. It also allows any person to request physical copies of any given registration statement.

Law 1676 provides a variety of safeguard mechanisms for both debtors and creditors to monitor the assets that are subject to a security interest. For example, Law 1676 provides that creditors need to be authorized by debtors in order to file, modify or extend a security interest

and that creditors may authorize a third party to conduct such filing or modification on their behalf. Law 1676 also establishes that a registration statement is only valid for the period set forth in the registration statement, which may be extended for periods of three years. If the registration statement is silent as to the period during which it will be valid, the law specifies that the registration statement is valid for five years.

Enforceability of a Security Interest Against Third Parties (*Oponibilidad*)

Law 1676 provides three new methods to enforce a security interest over movable assets against third parties: (i) enforceability through the filing of a registration statement, (ii) enforceability through possession (*tenencia*) and (iii) enforceability through control.

As a general rule, a security interest over a movable asset is enforceable against third parties once a registration statement is filed with the national public registry.⁴ In some cases, a security interest may be enforceable against third parties through possession (*tenencia*) of the collateral by the creditor, even if a registration statement is not filed.⁵ A security interest over deposits in bank accounts is enforceable against third parties if the creditor (or an entity acting on behalf of the creditor) exercises control⁶ over the deposits subject to the guarantee.

The new law also provides rules on priorities of security interests. Pursuant to Law 1676, the priority of a security interest over an asset subject to two or more security interests depends on the method used for the enforceability of a security interest against third parties. A security interest filed with the national public registry has priority over a security interest that was not so filed (except in cases when a security interest can be enforced through possession or control, in which case the priority would depend on the time the security interest became enforceable against third parties). If no security interest was filed (and the security interest is not a security interest that can be enforced against third parties through

possession or control), priority will be determined based on the execution date of the underlying security agreement.

Expedited Process to Enforce a Security Interest Against Debtors

Another salient feature of Law 1676 relates to the various mechanisms established to enforce a security interest against debtors. Depending on what was agreed by the parties in the security agreement, a creditor may seek to enforce a security interest against the debtor through a civil court proceeding (as set forth under the Colombian Procedural Code), or through two new mechanisms introduced by the law: extrajudicial enforceability and direct payment.

Law 1676 allows a creditor and a debtor to agree on the extrajudicial process that a creditor needs to follow in order to enforce a security interest. If the parties have not agreed on that process, the debtor and the creditor need to follow the process set forth under Law 1676 that requires the creditor to file an enforceability statement before the national public registry and to instruct a Chamber of Commerce or a notary public to notify the debtor of such filing. The notification of the enforceability statement limits the debtor's ability to sell or transform the asset subject to the security interest. The debtor will be responsible for any damages caused to the creditor if the assets are transformed or sold after the date the enforceability statement was filed.

A creditor may also enforce a security interest against a debtor through the so-called "direct payment" method, if agreed by the parties in the security agreement or if the creditor is in possession (*tenencia*) of the collateral. Under this mechanism, a creditor may directly sell the collateral for the appraised value of such collateral set by the Superintendence of Companies (*Superintendencia de Sociedades*). No judicial process needs to be followed. Nonetheless, if a debtor is in possession (*tenencia*) of the collateral and fails to relinquish the collateral to the creditor, the creditor may

initiate a summary proceeding against the debtor to force the debtor/guarantor to relinquish the collateral.

Moving Forward

Law 1676 provides the basic tools to facilitate the creation, perfection, enforceability, termination and monitoring of security interests over movable assets. However, the Colombian government (including the Superintendence of Companies and the Superintendence of Finance (*Superintendencia Financiera*)) needs to rapidly issue regulations that guarantee that the new mechanisms are properly applied by, for example, implementing tools that guarantee the transparency, monitoring and accessibility of the new national registry (which are key to the success of this new law) and promoting the new system with banks and other lending institutions so that PYMES and other entities can be informed of the benefits of the new law.

Please note that Mayer Brown is not licensed to practice Colombian law and this is not legal advice or a legal opinion. You should consult with Colombian counsel should you wish to have additional information on this matter.

For more information about the topics raised in this Legal Update, please contact any of the following lawyers.

Douglas A. Doetsch

+1 312 701 7973

ddoetsch@mayerbrown.com

David K. Duffee

+1 212 506 2630

dduffee@mayerbrown.com

Juan P. Moreno

+1 312 701 8141

jmoreno@mayerbrown.com

Endnotes

- ¹ *Ley No.1676 del 20 de Agosto de 2014 “Por la Cual se Promueve el Acceso al Crédito y se Dictan Normas sobre Garantías Mobiliarias”.*
- ² Pursuant to Law 590 of 2000, PYMES are, in general terms, entities that have no more than 200 employees and assets with a value not exceeding US\$5million.
- ³ In 2014, the “Doing Business” ranking published by the World Bank ranked Colombia as one of the worst countries in the world when it comes to enforcing a contract, placing Colombia 155th out of the 189 countries ranked. The ranking was based on the length of time that it takes to enforce a contract (1,288 days), the amount of procedures and steps involved (34), and the costs vis-à-vis the debt value of the contract (nearly 45%). The ranking also placed Colombia 25th out of the 32 countries ranked in Latin America when it comes to enforcing a contract. These results (and the ranking results from previous years, 157th in 2013, 149th in 2012 and 150th in 2011) were the culprit for the Colombian government to enact a new law to facilitate the enforcement of security interests over movable assets.
- ⁴ Pursuant to Article 22 of Law 1676, a PMSI is enforceable against third parties only when a registration statement has been properly filed.
- ⁵ For example a “pledge with possession” (*prenda con tenencia del acreedor*) does not require the filing of a registration statement in order for it to be enforceable (*oponible*) against third parties.
- ⁶ Law 1676 defines control as an agreement or understanding between the depositary, the debtor/guarantor and the creditor whereby the depositary agrees to comply with the instructions of the creditor with respect to any amounts deposited in the secured accounts.

Mayer Brown is a global legal services organization advising many of the world’s largest companies, including a significant portion of the Fortune 100, FTSE 100, DAX and Hang Seng Index companies and more than half of the world’s largest banks. Our legal services include banking and finance; corporate and securities; litigation and dispute resolution; antitrust and competition; US Supreme Court and appellate matters; employment and benefits; environmental; financial services regulatory & enforcement; government and global trade; intellectual property; real estate; tax; restructuring, bankruptcy and insolvency; and wealth management.

Please visit our web site for comprehensive contact information for all Mayer Brown offices. www.mayerbrown.com

IRS CIRCULAR 230 NOTICE. Any advice expressed herein as to tax matters was neither written nor intended by Mayer Brown LLP to be used and cannot be used by any taxpayer for the purpose of avoiding tax penalties that may be imposed under US tax law. If any person uses or refers to any such tax advice in promoting, marketing or recommending a partnership or other entity, investment plan or arrangement to any taxpayer, then (i) the

advice was written to support the promotion or marketing (by a person other than Mayer Brown LLP) of that transaction or matter, and (ii) such taxpayer should seek advice based on the taxpayer’s particular circumstances from an independent tax advisor.

Mayer Brown is a global legal services provider comprising legal practices that are separate entities (the “Mayer Brown Practices”). The Mayer Brown Practices are: Mayer Brown LLP and Mayer Brown Europe – Brussels LLP, both limited liability partnerships established in Illinois USA; Mayer Brown International LLP, a limited liability partnership incorporated in England and Wales (authorized and regulated by the Solicitors Regulation Authority and registered in England and Wales number OC 303359); Mayer Brown, a SELAS established in France; Mayer Brown JSM, a Hong Kong partnership and its associated entities in Asia; and Tauil & Chequer Advogados, a Brazilian law partnership with which Mayer Brown is associated. “Mayer Brown” and the Mayer Brown logo are the trademarks of the Mayer Brown Practices in their respective jurisdictions.

This Mayer Brown publication provides information and comments on legal issues and developments of interest to our clients and friends. The foregoing is not a comprehensive treatment of the subject matter covered and is not intended to provide legal advice. Readers should seek specific legal advice before taking any action with respect to the matters discussed herein.

© 2014 The Mayer Brown Practices. All rights reserved.