

2007

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Recommended Citation

Carlos Gerscovich, *Deferred Payment Checks in Argentina (Cheques de Pago Diferido en Argentina)*, 13 LAW & BUS. REV. AM. 1013 (2007)
<https://scholar.smu.edu/lbra/vol13/iss4/15>

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DEFERRED PAYMENT CHECKS IN ARGENTINA (CHEQUES DE PAGO DIFERIDO EN ARGENTINA)

*Carlos Gerscovich**
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I. INTRODUCTION

THE purpose of this paper is to consider the widespread use of deferred payment checks (CHPDs) in Argentina in recent years, especially since they became negotiable on the stock exchange.

For such purpose, we will make use of the relevant information recently surveyed, which supports our initial statement. Also, when analyzing this subject, we will take into account the legal, economic, and political reasons why, in our opinion, the use of CHPDs has increased exponentially.

Five years after the last devaluation and the abrupt lapse of many investment contracts with the traditional investment choices, such as fixed-term deposits and dollar yielding small profits, savers or small investors are forced to seek new alternatives for financial investments in order to preserve or increase their savings. As a matter of fact, new investment securities, which appeared in the last few years, are gathering momentum in the wake of the last economic catastrophe that struck Argentina in December 2001.

These new securities are characterized, as economists affirm, by pumping funds into the real economy, thereby contributing, sustaining, and boosting economic activity.¹ This is how in the last ten years a noticeable development of financial or guarantee trusts, the issuance of debt securities by private companies, such as negotiable bonds (*obligaciones negociables* or ON) and, lately, the deferred payment checks has ensued in our daily working environment.

All of these securities are used as financial vehicles by small and medium-sized companies (PYMES) for their expansion projects, which do

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1. Javier Blanco, *Strategies to Overcome Inflation*, LA NACION, Feb, 25, 2006, Economy & Business Section, available at <http://www.lanacion.com.ar> (translated by the authors).

not involve big amounts, but do really have a significant impact in their respective activities, as was the case in certain sectors, such as farm production and real estate building.²

II. DEFERRED PAYMENT CHECK

Basically, the notion of CHPDs can be understood in our opinion as a kind of letter of exchange, actually drawn against a bank, in order to be paid at a certain time after its issuance date.

Pursuant to Law No. 24452 (the Check Act), two kinds of checks exist in Argentina: the common check and the deferred payment check.³

Although it is not usual for Argentine laws governing the exchange of marketable securities to include any definitions of credit instruments, the notion we are dealing with here, CHPDs, is defined in the very text of the Check Act in section 54.⁴

To date, the only countries where CHPDs exist are Argentina, Uruguay, and Paraguay. This is why it is very difficult to find, presently, in the United States or Europe, any similar concept that could fully match this instrument.

In our country, since the reform introduced by Law No. 24760 of 1997, CHPDs are used more frequently, even though they had already been introduced in the Check Act before the above-mentioned reform.⁵ Since December 2003, when they became susceptible to negotiation on the stock exchanges, they have gathered the momentum which has encouraged us to write this paper.

Ever since its quotation on the Buenos Aires Stock Exchange, a check can be discounted at a banking institution which endorsed at a discount rate can be on average over 20 percent, depending on whether the company is a regular customer of the bank or not and on the amount involved in the transaction.

This kind of transaction is usually performed at high discount rates, thus making it really inconvenient for PYME's managers. At the same time, businesses could also discount their checks without so many requirements in informal environments, the so called "caves," which used to apply rates up to 25 percent of the amount of the check.

Presently, because checks can be listed on the stock exchange, the companies that used to seek funding by discounting their CHPDs while paying very high rates now negotiate them directly on a transparent market, where the free game of supply and demand can determine the payable

2. See Law for the Promotion of Micro, Small, and Medium-Sized Companies, Law No. 25300, Sept. 7, 2000, [29478] B.O. 2-5 (Arg.).

3. Check Act, Law No. 24452, Mar. 2, 1995, [28094] B.O. Annex 1 (Arg.).

4. *Id.* § 54. The deferred payment check is a money order, drawn to be paid at a certain later date with respect to its issuance, against an authorized entity where the drawer must either have, upon the maturity thereof, enough funds deposited on its behalf in a current account or authorization to overdraw. *Id.*

5. Law No. 24760, Jan. 13, 1997, [28562] B.O. 1-3 (Arg.) (creates negotiable instruments—credit invoices).

rate. Today, the average rate normally paid in the secondary market is nearly half as much the one formerly applied in the informal market where it was not as safe as it is today.

III. TRADING ON THE STOCK EXCHANGE

With the abovementioned reform introduced by the Check Act, deferred payment checks could be negotiated on the stock exchanges and self-regulated securities markets and issued checks could be endorsed as "not to the order of" [i.e. as and with the effects of an assignment of rights], provided that they were deposited in Securities Depositary (Caja de Valores S.A.) with the purpose of negotiating them at a future date. The Central Bank of the Argentine Republic (BCRA) and the National Securities Commission (CNV) were both instructed to issue their respective regulations within their competences, and they have acted accordingly.

Deferred payment checks were specially created with the purpose that PYMES could have an alternative credit facility other than banks. Companies can thus obtain funds by negotiating these checks on the stock exchanges. The trading of said checks has increased remarkably ever since 2004 on the Buenos Aires Stock Exchange. Those who thus operate with these checks have chosen this mechanism to discount them and thereby obtain working capital at competitive rates in an agile and transparent way.

Today, CHPDs are an effective vehicle to manage liquidity in the short-term by managing the negative effects caused by inflation in savers' and investors' purchasing power because they are securities which are easy to use and widely acceptable for investors. In this respect, financial analysts and professionals dealing with these securities both identify the major cause for the great development of CHPDs on the stock exchange as a growing inflationary expectation, which has investors demanding higher returns, especially in those fixed-rate securities.

Thus, the benefits of negotiating checks include the access to better rates, the possibility of endorsement and, above all, the access to the capital market.

A. TRANSACTIONS AUTHORIZED BY THE NATIONAL SECURITIES COMMISSION (CNV)

The transactions authorized by the CNV may take one of the following forms:

- a) Sponsored deferred payment checks: They are drawn in favor of third parties by business companies legally incorporated, cooperative corporations, civil and mutual-benefit associations and foundations, endorsed by the payee in favor of Caja de Valores Sociedad Anónima with the legend established as indicated in

Decree No. 386/2003.⁶ They are then deposited in Caja de Valores Sociedad Anónima pursuant to the regulations issued by the stock exchanges, in order to include in this activity all those companies that request prior authorization to draw deferred payment checks to be offered on the market.

- b) Guaranteed deferred payment checks: They are drawn in favor of their stakeholders by reciprocal guarantee companies (*sociedades de garantía recíproca* or SGR, as per its acronym in Spanish) or other types of companies described in Law No. 25300 and representative certificates issued by financial institutions that provide guarantees on deferred payment checks.⁷

Under this system there may be two basic kinds of transactions: the discount of third-party checks, which are the CHPDs received by a stakeholder (*socio partícipe*) and normally drawn or endorsed by its clients, and the discount of one's individual checks, which are money orders issued by the stakeholder in its own name.

On the other hand, the BCRA resolved that if the holder of a current account chooses to accept that its checks may be negotiated on any stock exchange, the financial institution shall furnish checkbooks containing formulas with the printed legend "Trading on Stock Exchanges," in accordance with Decree No. 388 dated July 10, 2003.⁸ As to the endorsement, it must be issued with the clause "for trading on stock exchanges."⁹

Since the trading of checks will take place on stock exchanges or securities markets, it will be conducted by stock brokers or stock brokerage companies duly registered with the corresponding market regulators.

B. REGULATIONS OF THE BUENOS AIRES STOCK EXCHANGE

Pursuant to the "Regulations Governing the Listing of Deferred Payment Checks" issued by the Buenos Aires Stock Exchange, there are two different forms—sponsored checks and guaranteed checks.¹⁰

1. Listing of Sponsored Checks

In this case, legally incorporated business companies, cooperative corporations, civil and mutual-benefit associations, and foundations (the drawers) may petition for authorization to list the checks they may issue in favor of third parties by complying with the following requirements:

- Issued for an amount of at least AR\$1,000

6. Decree 386, July 15, 2003, [30191] B.O. 1-2 (Arg.) (checks).

7. Law No. 25300, [29478] B.O. 2-5.

8. Decree 388, July 15, 2003, [30191] B.O. 2 (Arg.) (salaries).

9. *Id.*

10. Resolution No. 2/2003, Buenos Aires Stock Exchange, Jul, 10, 2003, Published by Buenos Aires Stock Exchange Bulletin on Oct, 20, 2005 and modifications (www.bolsar.com/NET/noticias/resoluciones/resoluciones.aspx). Regulation of National Securities Commission New Text 2001 (Text Approved by General Resolution 368, updated until General Resolution 513) (www.cnv.gov.ar/LeyesReg/marco_regulatorio3.asp?Lang=0&item=3).

- Endorsed by the payee in favor of Caja de Valores S.A. with the expression “Endosado a la Caja de Valores para su negociación en el Mercado de Valores de Buenos Aires S.A.” [“Endorsed to Caja de Valores for trading on the Mercado de Valores de Buenos Aires S.A.”], and deposited therein by a stock broker or stock brokerage company.

2. *Listing of Guaranteed Checks*

Reciprocal guarantee companies may petition for authorization to list the checks guaranteed by them in favor of their stakeholders.

Financial institutions may petition authorization to list certificates, under the conditions specified for the “Listing of sponsored checks”. Such certificates are regulated by section 58 of the Check Act, under the chapter dealing with the deferred payment check, as follows:

Section 58: The institutions concerned shall issue endorsable certificates, pursuant to the pertinent regulations issued by the Central Bank of the Argentine Republic, in case they guarantee a deferred payment check, which shall remain deposited in the institution providing said guarantee.

Sección 58: Las entidades interesadas emitirán certificados transmisibles por endoso, conforme lo reglamente el Banco Central de la República Argentina, en los casos en que avalen cheques de pago diferido, el cual quedará depositado en la entidad avalista.¹¹

In short, marketable securities may include deferred payment checks (sponsored by the drawer or guaranteed by a reciprocal guarantee company) or certificates issued by a financial institution when the check will remain deposited in said institution.

C. HOW TO PURCHASE THESE CHECKS ON THE STOCK EXCHANGE

This investment consists of buying a deferred payment check by paying its face value and taking off the discount rate. Upon maturity of the check, 100 percent of the check’s face value will be cashed. Stock brokerage companies usually compare them with a short-term zero-coupon bond.

Another choice can be a secured check where if the drawing company does pay the amount when due, the company providing the guarantee shall automatically pay the total sum. This is why stock brokerage companies recommend it as a low- or zero-risk security. Alternatively, there are unsecured checks which are issued by companies listing their own checks. In this case, the risk for the investor lies in the drawing company. Today, this instrument is more profitable than fixed-term deposits (6 to 7.5 percent). Liquidity is immediate, and the check can be sold on the market. Investors may choose the term, from thirty to 360 days. The estimated return is between 7 and 12 percent p.a., depending on the term and

11. *Id.* § 58.

amount of the check.¹²

D. ANY COUNTERPART IN THE UNITED STATES OF AMERICA

There is no equivalent of the deferred payment check or any other similar instrument that can be negotiated on the American Stock Exchange. In our opinion, as it is now functioning in Argentina, it is a concept advertised by government authorities mainly because of a need to promote the circulation of credit and funding, especially for PYMES since the last economic crisis of Argentina, rather than an idea to innovate in the legal domain. In other words, we believe that political and economic reasons outweighed legal ones at the time this instrument was created and implemented.

The most similar notion we have found in the United States to the instrument under consideration are documents susceptible to discount rates such as the acceptance and its variant, the draft. But note that the draft would not be susceptible to a discount rate and may be issued by a bank.

IV. SOME STATISTICS

The market of deferred payment checks has increased fourfold in one year. Far from their initially scarce liquidity, these instruments have gained participation and trading. As early as March of 2006, they reached a record high with AR\$37.58 million in trading.

It was widely known that, in the first months of the last year, the Buenos Aires Stock Exchange played a major role as an essential player in the trading of deferred payment checks. At the beginning, its intervention consisted of almost 90 percent of all the transactions, thus seeking to create liquidity. Today, such a ratio is virtually next to zero. The check market seems to have gained both liquidity and trading. For analysts, this new record seems to account for that. So, it is a booming market.

In a year-to-year comparison, by the end of the first quarter of 2006, there was a 280-percent increase.¹³ During March, more than 1,350 checks were traded with an average amount of AR\$27,800, which is similar with that of previous months. The average term of the traded securities was 100 days. As to guaranteed checks, they accounted for the largest market share, amounting to AR\$27.8 million, which represents 75 percent of all trading. During 2005, they accounted for 65 percent of trading, evidencing a growth in the concentration of trading in this kind of instruments. On the other hand, sponsored checks kept their market share

12. See Miguel Benedit, *Compra de cheques de pago diferido en la Bolsa de Comercio de Buenos Aires*, *INVERSOR GLOBAL*, Nov, 10, 2005, http://www.inversorglobal.com.ar/oportunidades_de_inversion/cheques_de_pago_diferido.

13. See *Prevén mejores condiciones para la deuda privada en 2006*, *INFOBAE PROFESIONAL*, Sección Economía, Feb, 2, 2006, (<http://www.infobaeprofesional.com/notas/nota.php?Idx=239164&Idxseccion=0>) And data of the official sites of the central bank, stock markets and National Securities Commission.

with 25 percent of all trading and transactions for a total amount of AR\$9.2 million.

According to the data shown by the CNV in its annual report published in 2005, 8,002 deferred payment checks were traded for an amount exceeding AR\$200 million, which means a 376-percent increase on a year-to-year basis.¹⁴ Almost two-thirds of this amount corresponded to sponsored checks. Statistics also show an extension of the average terms of the checks traded at a discount. Both in the sponsored check and guaranteed check segments of the market, there was an increase in the average discount rate compared with 2004. One of the reasons is that in 2005 less well-known companies joined this practice, which implied a greater associated risk. There are seventeen guarantor institutions registered, all of which are reciprocal guarantee companies, and forty-seven sponsoring institutions.

**NEGOCIACIÓN DE CHEQUES DE PAGO DIFERIDO
DEFERRED PAYMENT CHECK TRADING**

Años / Years	Valores Neg.en millones \$ Marketable Securities in Million \$	Cantidad de Cheques Number of Checks	Tasa Pasiva Promedio Average Borrowing Rate
2003(1)	0,33	13	5,31
2004	44,30	1391	5,62
2005	208,20	8002	*

(1) Corresponde a un solo mes de operaciones / (1) Relevant to one trading month only.

* La tasa promedio varia entre cheques de pago diferido patrocinados o avatados.

* The average rate changes between guaranteed and sponsored deferred payment check. *Annual Report 2005. National Securities Commission (Comisión Nacional de Valores, www.cnv.gov.ar)*

This trend went upwards during the first half of 2006, as expected, since those using this instrument think that it especially makes PYMES funding easier, while it is an initial step for them to join the local capital market.

CHPDs' trading on the Buenos Aires Stock Exchange grew more than 220 percent in the first half of 2006, with total transactions valued at AR\$36.9 million. The daily average trading of CHPDs equaled AR\$176 million, as more than 1,500 securities were traded for the second month in a row. The average amount fluctuated around AR\$23,000 with an average term of 100 days.¹⁵

14. Annual Report 2005. National Securities Commission (Comisión Nacional de Valores, www.cnv.gov.ar/Publicaciones/Anuario2006/contenidoCD-CNV2006.pdf).

15. *Creció la Negociación de Cheques de Pago Diferido*, EL DIARIO QUE VIENE (Press Office of Mercado de Valores de Buenos Aires, Stock Exchange of Mar del Plata, Arg.), Aug. 2, 2006, at 2, available at http://www.bcmdp.com.ar/el_diario_que_viene.

According to the data shown by the CNV in its annual report of 2006, published in 2007, CHPDs' trading volume in 2006 doubled the figure for the previous year (ENDNOTE 16). Out of the 18,901 checks traded in 2006, 17,201 were guaranteed checks and 1,700 were sponsored checks. Average terms have been extended. Interest rates change depending on the type of traded check, whether sponsored or guaranteed. See next figure.

NEGOCIACIÓN DE CHEQUES DE PAGO DIFERIDO
DEFERRED PAYMENT CHECK TRADING

Años	Valores Neg. en millones \$	Cantidad de Cheques	Tasa Pasiva Promedio
<i>Years</i>	<i>Securities Traded in Ar\$ million</i>	<i>Number of Checks</i>	<i>Average Borrowing Rate</i>
2003 ⁽¹⁾	0.33	13	5.31
2004	44.30	1.391	5.62
2005	208.20	8.002	*
2006	430.82	18.901	*

(1) Corresponde a un solo mes de operaciones / *Pertaining to only one month trading.*

* La tasa promedio varía entre cheques de pago diferido patrocinados o avalados / *The average rate depends on whether DP checks are guaranteed or sponsored.*

Figure 10 - Fuente: CNV en base a IAMC /

Figure 10 - Source: CNV based on IAMC

Annual Report 2006. National Securities Commission

V. CONCLUSION

As obvious as it may seem, we can affirm that the government authorities' objective to encourage the use of CHPDs as a financial instrument for those economic players with limited access to credit has been successful.

On the other hand, it is a commonly poor practice in Argentina to look to the future in times of crisis. In other words, under such circumstances, as if there were no other solution, actions are directed to modify pre-existing situations and to promote new ways, all of which ultimately entail the evolution of institutions.

CHPDs are used in a variety of ways on the major stock exchanges throughout the country. Despite differences their growth has been remarkably strong. Strictly speaking from the point of view of stock exchange trading, those market institutions have attempted to consolidate their objectives by making their structures more professional and inserting the instruments available on the market. In Argentina's new sce-

nario, set by the surmounting of its debt default and a general recovery of its economy, there arises a context of credit flourishing based on the instrument analyzed herein, which is an interesting tool to use the knowledge acquired and pursue a sustainable growth based on such achievements.

