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Report of Working Group VI (Security Interests) on the work of its thirty-fourth session (Vienna, 17–21 December 2018)

I. Introduction

1. At its present session, Working Group VI (Security Interests) continued its work on the preparation of a draft practice guide to the UNCITRAL Model Law on Secured Transactions ("Practice Guide"), pursuant to a decision taken by the Commission at its fiftieth session (Vienna, 3–21 July 2017).[1] At that session, there was support in the Commission to provide guidance to users (such as parties to transactions, judges, arbitrators, regulators, insolvency administrators and academics) of the UNCITRAL Model Law on Secured Transactions ("Model Law") to maximize the benefits of secured transactions laws.[2]

2. The Commission agreed that broad discretion should be accorded to the Working Group in determining the scope, structure and content of the draft Practice Guide, but it was felt that the draft Practice Guide could address the following: (a) contractual issues (such as the types of secured transaction that were possible under the Model Law); (b) transactional issues (such as the valuation of collateral); (c) regulatory issues (such as the conditions under which movable assets were treated as eligible collateral for regulatory purposes); and (d) issues relating to finance to micro-businesses (such issues relating to the enforcement of security interests).[3]

3. At its thirty-second session (Vienna, 11–15 December 2017), the Working Group commenced its work on the draft Practice Guide based on a note by the Secretariat entitled Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions: Annotated List of Contents (A/CN.9/WG.VI/WP.75) and requested the Secretariat to prepare a first draft of the Practice Guide, reflecting the deliberations and decisions of the Working Group (A/CN.9/932, para. 9). At its thirty-third session (New York, 30 April–4 May 2018), the Working Group completed its first reading of the draft Practice Guide based on a note by the Secretariat (A/CN.9/WG.VI/WP.77) and requested the Secretariat to prepare a second draft reflecting the deliberations and decisions of the Working Group (A/CN.9/938, para. 10).

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[1] *Official Records of the General Assembly, Seventy-second Session, Supplement No. 17* (A/72/17), paras. 227 and 449.
[2] Ibid., para. 222.
[3] Ibid., paras. 227 and 449.

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4. At its fifty-first session (New York, 25 June–13 July 2018), the Commission expressed its satisfaction with the progress made by the Working Group and noted the Secretariat's efforts to coordinate with the Basel Committee on Banking Supervision (BCBS) with respect to the regulatory aspects. Considering the progress made, the Commission requested the Working Group to complete the work expeditiously, with a view to presenting a final draft to the Commission for consideration at its fifty-second session in 2019.[4]

II. Organization of the session

5. The Working Group, which was composed of all States members of the Commission, held its thirty-fourth session in Vienna from 17 to 21 December 2018. The session was attended by representatives of the following States members of the Working Group: Armenia, Australia, Belarus, Brazil, Canada, China, Czechia, Ecuador, El Salvador, France, Germany, Hungary, India, Indonesia, Iran (Islamic Republic of), Italy, Japan, Kenya, Kuwait, Mexico, Namibia, Pakistan, Philippines, Poland, Republic of Korea, Romania, Russian Federation, Spain, Switzerland, Thailand, Turkey, United Kingdom of Great Britain and Northern Ireland and United States of America.

6. The session was attended by observers from the following States: Belgium, Dominican Republic, Jamaica, Jordan, Slovakia, Turkmenistan and Yemen.

7. The session was also attended by observers from the following international organizations:

(a) *United Nations system*: World Bank;

(b) *Intergovernmental organizations*: Cooperation Council for the Arab States of the Gulf (GCC), European Investment Bank (EIB), International Institute for the Unification of Private Law (UNIDROIT);

(c) *International non-governmental organizations invited by the Commission*: American Bar Association (ABA), Centro de Estudios de Derecho, Economía y Política (CEDEP), Commercial Finance Association (CFA), Factors Chain International and the EU Federation for Factoring and Commercial Finance Industry (FCI and EUF), Forum for International Conciliation and Arbitration (FICA), International Insolvency Institute (III), International Law Institute (ILI), Law Association for Asia and the Pacific (LAWASIA), Moot Alumni Association (MAA) and National Law Centre for Inter-American Free Trade (NLCIFT).

8. The Working Group elected the following officers:

Chairperson: Mr. Bruce WHITTAKER (Australia)

Rapporteur: Ms. Ruenvadee SUWANMONGKOL (Thailand)

9. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.78 (Annotated Provisional Agenda), A/CN.9/WG.VI/WP.79, A/CN.9/WG.VI/WP.79/Add.1, A/CN.9/WG.VI/WP.79/Add.2 and A/CN.9/WG.VI/WP.79/Add.3 (Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions and addenda).

10. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions.

[4] Ibid., *Seventy-third Session, Supplement No. 17* (A/73/17), paras. 163 and 238.

5. Future work.

6. Adoption of the report.

III. Deliberations and decisions

11. The Working Group engaged in discussions based on a note by the Secretariat entitled "Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions" (A/CN.9/WG.VI/WP.79 and its addenda). The deliberations and decisions of the Working Group are set forth below in Chapter IV. At the close of the session, the Working Group requested the Secretariat to revise the draft Practice Guide to reflect the deliberations and decisions of the Working Group and to submit it to the Commission for consideration at its fifty-second session. Considering that the Working Group was not able to adopt chapters II.E to II.J of the draft Practice Guide (see paras. 78–82 below), it was agreed that the Secretariat should be given flexibility in preparing a revised version of those parts and in making any necessary consequential revisions to other parts of the draft Practice Guide which had been adopted by the Working Group.

IV. Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions

A. Introduction to the draft Practice Guide (A/CN.9/WG.VI/WP.79, paras. 1–20)

Purpose of the Guide (paras. 1–2)

12. The Working Group agreed that the footnote in paragraph 1 should be deleted.

13. With regard to paragraph 2, the Working Group agreed that the first sentence should be revised to state that the draft Practice Guide was intended to assist its readers to better understand the Model Law. It was agreed that the last sentence might include other stakeholders that might benefit from the draft Practice Guide.

14. Subject to those changes (see paras. 12–13 above), the Working Group adopted chapter I.A of the draft Practice Guide.

Key benefits of the Model Law (paras. 3–11)

15. The Working Group agreed that paragraph 3 could be revised along the following lines:

> Under the Model Law, a "security right" is a property right in a movable asset that a person (the "secured creditor") can exercise to recover money it is owed or to secure other obligations owed by another person (the "debtor"). A secured creditor can protect itself when … In most cases, the debtor will be the person that grants the security right (the "grantor") but a person can also grant a security right in its assets to secure the obligation of another person.

16. With respect to paragraph 4, it was agreed that:

- The second and third sentences should be placed first without highlighting the negative aspects of traditional legal systems;
- The first sentence would thus become the last sentence noting that in response to those traditional legal systems, there had been a development of a wide range of transactions, which might have resulted in the multiplicity and fragmentation of the secured transaction regime.

17. The Working Group agreed that paragraphs 5 to 8 should be restructured to include separate paragraphs, highlighting:

- The “comprehensive” scope of the Model Law whereby a security right could be created over any type of movable assets (the first sentence of para. 5 with the deletion of the words “in almost any way” would be combined with the first three bullet points of para. 6);
- The “functional” as well as the “unitary/integrated” approaches of the Model Law (the second and third sentences of para. 5 listing retention-of-title and financial lease transactions as examples);
- That transfer of possession was not required for granting a security right;
- That the security right extended to proceeds from a sale or any other dealing of the encumbered asset;
- Party autonomy provided under the Model Law (the last sentence of para. 5 would be combined with para. 8); and
- The fact that some of the above-mentioned transactions might not have been possible in a State that had not adopted the Model Law and that one of the objectives of then draft Practice Guide was to alert its readers of those possibilities.

18. With respect to paragraphs 9 and 10, the Working Group agreed that:

- Paragraph 9 should be revised to emphasize the ease of creating a security right under the Model Law, which would clearly distinguish between the act of creating a security right (by a written agreement) and the act of making the security right effective against third parties with the subheading “A simple and easy way to create a security right”;
- Footnote 2 should be deleted;
- The last sentence of paragraph 9 should be combined with paragraph 10 under the subheading “A simple and transparent registration system”; and
- The third sentence of paragraph 10 should read along the following lines: “The registration process is straightforward — a registrant only needs to register a simple notice and does not need to submit the security agreement or any other documents.”

19. The Working Group agreed to place paragraph 11 before paragraph 3 with the following changes:

- The subheading would be “Greater access to credit at a reasonable cost”;
- References to SMEs in the third sentence should be replaced with “many businesses” as chapter I.B highlighted the benefits of the Model Law in a general fashion and was not limited to benefits provided to businesses of a certain size; and
- The last sentence of paragraph 11 would highlight that a legal system that facilitated secured transactions using movable assets would enhance access to credit for businesses, enhance their ability to obtain credit at lower costs and extend the period of repayment of loans.

20. Subject to those changes (paras. 15–19 above), the Working Group adopted chapter I.B of the draft Practice Guide.

Secured Transactions involving micro-enterprises: need for particular attention (paras. 12–14)

21. With respect to paragraphs 12 to 14, it was agreed that:

- Paragraphs 12 to 14 should be reformulated into an example and commentary of a transaction involving a micro-enterprise, which would touch upon some of the features outlined in paragraph 12;
- The reformulated texts should avoid referring to the "informal" nature of micro-enterprises; and
- Text along the following lines should replace paragraphs 12 to 14 and be placed under chapter I.D.

"Secured transactions involving microenterprises

The Model Law is designed to improve access to finance and to lower the cost of credit for all kinds of enterprises. As mentioned, it is particularly well suited for SMEs, which are the most common form of businesses in most States.

The Model Law enables secured lending to micro-enterprises in situations where, previously, access to credit was limited because the security mechanisms suitable to secure such loans were not available or their cost structure would make such low value loans prohibitively expensive.

Example

Individual X applies for a loan to start a business selling food on the street. X does not have any business assets, only household items, including some cooking equipment. Lender Y provides a short-term loan secured with the household items to allow X to acquire supplies for the business using the trading name "Superfoods". After three months, the loan is repaid, and "Superfoods" is successfully established. Lender Y then provides another loan for a higher amount, this time secured with household items and money from the sale of food, to fund the operation of Superfoods.

The above is an example of a secured loan to a micro-enterprise. It illustrates certain features typical of many micro-enterprises, which can impact how a security is taken. The micro-enterprise is an individual and is not incorporated, so the loan is made to X. There is, therefore, little distinction between the business and the individual who owns and runs it. X's business does not need to be registered in any public register and even when Superfoods is well established, X might not have accounting books which can be used to determine cash flow.

These features illustrate that Lender Y needs to take particular care in certain respects. The lack of formal financial information and public registration may affect the type of due diligence that needs to be undertaken by Lender Y. This also means that close monitoring during the course of the loan will be advisable, for example, to find out about any changes of legal status, name or address which might otherwise not come to the attention of Lender Y and which could affect its ability to enforce its security right.

Lender Y will also need to bear in mind that its ability to enforce its security right may be limited by other laws of the enacting State, such as laws prohibiting the seizure of personal assets and laws limiting the amount to which a security right can be enforced."

Some things to bear in mind (paras. 15–20)

22. With respect to paragraph 15, it was agreed that the phrase "because they are not covered by the Model Law" be inserted at the end of the second sentence and that

the third sentence read as follows: “Guidance on good lending practices is provided only in the context of secured lending transactions.”

23. A proposal to revise footnote 1 and to re-insert it in paragraph 16 did not receive support.

24. With respect to paragraphs 16 and 17, the Working Group agreed that:

- The first, second and last sentences of paragraph 16 should be combined with paragraph 17 under a separate subheading “Terminology and definitions” and that the words “to understand exactly how the Model Law works in their State” be deleted from the first sentence of paragraph 17; and
- The subsection “The Guide does not address everything in the Model Law” would be composed of the second and third sentences of paragraph 16 and that the word “non-legal” be replaced with the word “non-legalistic”.

25. With respect to paragraph 18, it was agreed that:

- The phrase “for enacting States to adopt in their legislation” should be inserted at the end of the first sentence; and
- The second sentence (in particular, the phrase “to the extent possible”) would be reviewed after the Working Group had dealt with the different options in chapter II of the draft Practice Guide, while it was recalled that the objective of the draft Practice Guide was to provide practical guidance to parties on how to deal with the various options and not to provide guidance to legislators on the operation of those options, which was dealt with in the Guide to Enactment of the Model Law (“Guide to Enactment”).

26. With respect to paragraph 19, it was agreed that:

- “banking law” should be added as an example in the second sentence; and
- The last sentence should be deleted and be replaced with the following examples: (i) where the Model Law contemplates that the enacting State would insert a cross-reference to the relevant provisions of its laws regarding the steps that a judgment creditor will need to take to acquire rights in the encumbered asset (art. 37 of the Model Law) and (ii) where the requirements in other laws regarding offer and acceptance for concluding a valid and binding contract would apply to security agreements.

27. With respect to paragraph 20, it was recalled that the Working Group had agreed that the draft Practice Guide would not include any policy discussion on over-collateralization. After discussion, it was agreed that paragraph 20 should be retained under the current subheading with the following changes:

- The phrase “for example” should be deleted from the first sentence; and
- The second and third sentence should be combined and simplified along the following lines: “In such circumstances, the lenders should take due caution”.

28. Subject to those changes (see paras. 21–27 above), the Working Group adopted chapter I.D of the draft Practice Guide.

Other issues

29. A suggestion that it would be useful for the Practice Guide to indicate that States might want to adapt the Practice Guide reflecting how the Model Law had been enacted in that State was not supported.

30. It was agreed that chapter I of the draft Practice Guide should not provide cross-references to provisions of the Model Law nor to the remaining parts of the draft Practice Guide, whereas relevant cross-references could be made in chapter II of the draft Practice Guide.

B. How to engage in secured transactions under the Model Law (A/CN.9/WG.VI/WP.79, paras. 21–67 and A/CN.9/WG.VI/WP.79/Add.1)

1. Introduction to chapter II (A/CN.9/WG.VI/WP.79, para. 21)

31. With respect to paragraph 21, the Working Group recalled that it had agreed that transactions like securitization, value chain arrangements, and supply chain financing should only be mentioned briefly in the draft Practice Guide. However, it was felt that the types of arrangements mentioned differed in complexity and that the last sentence could be modified to read: "For example, the Model Law also facilitates supply chain financing and value chain arrangements, as well as more complex financing arrangements such as syndicated loans and securitization" (see also para. 45 below).

32. It was also agreed that paragraph 21 should indicate the primary intended audience of chapter II along the lines of paragraph 2 and emphasize that the list of transactions provided in section A was not exclusive.

2. How to take an effective security right (A/CN.9/WG.VI/WP.79, paras. 22–67)

Security over tangible asset(s) without taking possession

33. With regard to paragraphs 22 to 30, the Working Group agreed that:

- The heading should be revised as "Security over tangible asset(s) without having to take possession";
- The phrase "to take a loan" should be replaced with the phrase "to obtain a loan" throughout the draft Practice Guide;
- References to "sufficient property interest" or "interest" should be replaced with the word "right" throughout the draft Practice Guide (for example, the first bullet point of paragraph 22 would read: "Make sure that Company X (the grantor) has rights in the printing press or the power to encumber it (art. 6(1) of the Model Law)";
- In relation to Example #1, references should not be made to "steps" as they implied a sequence to be followed;
- The subheading of paragraph 23 should be revised as "Can Company X create a security right?";
- The last sentence of paragraph 23 should read as follows: "… even though that person is not the owner but has a lesser right in the asset or has the power to encumber it (for example, a lessee of a printing press may grant a security over its right to use the printing press)";
- The subheading of paragraph 24 should be revised as "Security for obligations owed by third parties";
- The first two sentences of paragraph 24 should read as follows: "The grantor will usually be the person who owes the secured obligation. The Model Law also allows a person to grant a security right in its assets to secure an obligation owed by another person";
- In paragraph 24, another example where a family member provided security for financing to another member of the family should be included;
- The last sentence of paragraph 24 would be supplemented by the following words as there might be limitations under other laws: "to the extent permitted by corporate, insolvency or other applicable laws";
- The words "(the terms of the loan)" should be deleted from paragraph 26 and a reference to article 6(3) of the Model Law added in that paragraph;

- Paragraph 27 should be elaborated along the following lines: “Some States may require that the security agreement indicate the maximum amount for which the security right may be enforced (art. 6(3)(d) of the Model Law). In those States, the security agreement …”;

- The first two sentences of paragraph 28 should be revised as follows: “A security right created accordingly will be enforceable against Company X. However, Bank Y will want to ensure that its security right is effective against third parties.”;

- Paragraph 29 would indicate that it would be possible for Bank Y to register a notice prior to the conclusion of the security agreement with Company X;

- Example #1B could deal with assets other than motor vehicles, which might be subject to specialized registration in some jurisdictions;

- The last sentence of paragraph 30 should be revised to read: “… Bank Y will need to ensure that the descriptions in the security agreement and in the notice cover all the vans rather than just a single van (art. 9 of the Model Law)”; and

- Paragraph 30 should include ways to describe all the vans (for example, by stating “all current and future vans” or by listing all of the vans individually).

Security over tangible assets, by taking possession

34. With respect to paragraphs 31 to 34, the Working Group agreed that:

- The reference to the rugs being in a warehouse could unduly complicate Example #2 and should be deleted;

- Paragraph 33 should include a cross-reference to article 18(2) of the Model Law;

- Paragraph 34 should explain the advantages of entering into a written security agreement even when the secured creditor took possession of the encumbered asset and accordingly, the first bullet point and footnote 5 in paragraph 33 as well as the first sentence of paragraph 34 should be deleted; and

- The last sentence of paragraph 34 should be modified along the following lines: “Bank Y may prefer to register a notice in the Registry in addition to taking possession to protect itself, should it later agree to relinquish possession of the rugs as the third-party effectiveness of its security right would be preserved.”

Security over future assets

35. With respect to paragraph 35, the Working Group agreed that the subheading should be titled “Security over present and future assets” and the second sentence should indicate that the description would be provided “in the security agreement”.

Security over all present and future assets (all-asset security)

36. With respect to paragraphs 36 to 38, the Working Group agreed that:

- The subheading should be titled “Security over all movable assets (all-asset security)”;

- As it would be prudent for the descriptions in the security agreement and the notice to be the same, the last sentence of paragraph 36 should read: “The same description could be used in the registered notice”;

- The words in parentheses in the last sentence of paragraph 37 should read as follows: (for example, if Company X’s assets include shares, see example #6 …); and

- In response to concerns about the extent to which the Model Law allowed the secured creditor to dispose of the grantor’s business as a going concern,

paragraph 38 should read as follows: “If Company X defaults on its obligation to pay the loan, Bank Y can dispose of the assets separately or dispose of all the assets together. Depending on other laws of the enacting State, sale of all assets together may facilitate the sale of Company X’s business in its entirety. Any such sale would need to be in accordance with the enforcement provisions of the Model Law.”

Financing the acquisition of tangible assets

37. With respect to paragraphs 39 to 45, it was agreed that:

- Paragraph 39 should be revised along the following lines: “While only examples #5B and #5C refer to granting a ‘security right’, all four examples are considered to be granting a security right under the Model Law. Moreover, because the security rights granted under all four examples could qualify as ‘acquisition security rights’ under the Model Law, they may have priority over security rights for which a notice had already been registered.”;
- The meaning of fourth, fifth and sixth sentences of paragraph 40 should be clarified and accordingly: (i) the fourth sentence should read: “The Model Law looks to the underlying commercial objectives of the transaction and recognizes that the retention-of-title by Vendor Y is a security mechanism”; (ii) the phrase “for this reason” in the fifth sentence should be deleted; and (iii) the phrase “under the Model Law” should be inserted after the word “treated” in the sixth sentence;
- The second sentence of paragraph 41 should be supplemented with the following: “, which is secured by a security right granted by Vendor Y over the paint.”;
- The second sentence of paragraph 45 should read as follows: “…, its security right will have priority over security rights of non-acquisition secured creditors that have registered a prior notice covering future assets of the same kind.”

Security over company’s shares (in the case of a corporate group)

38. With respect to paragraphs 46 to 49, the Working Group agreed that:

- Example #6 should begin with more general wording along the following lines: “A manufacturing business is operated through a group of private wholly-owned companies. Mr. X owns all the shares of Company A, the holding company of the group. Company A owns all the shares of the three subsidiaries, Companies B, C and D …”;
- The phrase “held by Mr. X and Company A” in the penultimate sentence of paragraph 46 should be replaced with “owned by Mr. X in Company A”;
- The phrase “, and to produce a better sale price” in paragraph 46 should be deleted;
- The first sentence of paragraph 47 should be revised along the following lines: “Bank Y could make its security right effective over all assets of Company A (including shares it owns in Companies B, C and D) and over shares in Company A owned by Mr. X by registering a notice in the Registry”;
- The phrase “As an alternative (or in addition)” in the second sentence of paragraph 47 should be deleted;
- Footnote 7 should be aligned to reflect the different options contains in article 27 of the Model Law; and
- Reference could be made to article 51 of the Model Law that gave priority to secured creditors that made their security right effective against third parties as illustrated in paragraph 48.

Security over bank accounts

39. With respect to paragraphs 50 to 53, the Working Group agreed that:

- A separate example box should be inserted in relation to paragraph 51, which dealt with a situation where a security right over a bank account is created in favour of the bank where the account was maintained;
- The last sentence of paragraph 51 should be deleted; and
- The priority given to a deposit-taking institution (in para. 51) and a secured creditor that had made its security right effective against third parties by control agreement (in para. 52) should be mentioned with a cross-reference to article 47 of the Model Law.

Security over negotiable instrument

40. With respect to paragraphs 54 and 55, it was agreed that:

- The last sentence of paragraph 55 should read along the following lines: "The security right of Bank Z would not have priority over the rights of a buyer of the instrument that obtained possession …"; and
- Reference should only be made to article 46(2) of the Model Law at the end of paragraph 55 and the example in parentheses deleted.

Sale or outright transfer of receivables

41. With respect to paragraphs 56 to 60, the Working Group agreed that:

- Example #9 as well as the commentary should focus on "outright transfer of receivables" rather than on factoring generally;
- In Example #9, the word "creditworthy" should be replaced with the word "collectible" and the last sentence deleted;
- Paragraph 56 should be elaborated to state that the priority provisions of the Model Law would apply to competing rights in the receivables;
- Paragraphs 58 and 59 could be merged into a brief paragraph on factoring, which would be placed after paragraph 60 and that paragraph could highlight the complexities of factoring arrangements as well as the difficulty of distinguishing between outright transfers and transfers for security purposes within the factoring context; and
- The second sentence of paragraph 60 should be deleted.

Inventory and receivables financing

42. With respect to paragraphs 61 and 62, the Working Group agreed that:

- Paragraph 61 should include cross reference to the provisions of the Model Law dealing with the rights and obligations of the debtors of the receivable (arts. 61–67 of the Model Law);
- Reference in the last sentence should be to the new example contemplated in relation to paragraph 51; and
- Paragraph 62 should be simplified and included as part of Example #10.

Security over intellectual property

43. With respect to paragraphs 63 and 64, it was agreed that:

- Example #11 should be recast to illustrate a business that would grant a security right in different types of intellectual property both present and future, including its rights as an intellectual property licensee;
- Paragraph 63 should better reflect article 1(3)(b) of the Model Law; and

- The commentary could discuss in brief fashion how articles 17 and 99 of the Model Law would operate while focusing on how to take an effective security right over intellectual property.

Security over proceeds

44. With respect to paragraphs 65 to 67, the Working Group agreed that:

- Example #12 should be revised so that Company X received a cheque from Company Z for the sale of the printing press;
- In addition to the point that the security right extended to identifiable proceeds, there was a need to state the general rule in the Model Law that a security right made effective against third parties continued to encumber the asset notwithstanding its sale or other transfer (art. 34(1) of the Model Law);
- The broad notions of "proceeds" and "proceeds of proceeds" under the Model Law should be elaborated with possible examples (money received, insurance claims, fees received when the asset was leased and others); and
- Paragraphs 66 and 67 should provide clearer guidance to a secured creditor on what measures it should take to make its security right in proceeds effective against third parties depending on the types of proceeds and include how to describe such assets in the security agreement and/or in the notice.

Other issues

45. With regard to the suggestion that it would be useful to outline that the types of transactions illustrated in chapter II.A (and their combination) could facilitate a wide range of asset-based financing products, it was agreed that paragraph 21 should be expanded along the following lines: "Transactions, or elements of transactions, illustrated in this Chapter are often combined to develop different secured lending products. For example, modern agriculture finance products rely on security over negotiable instruments, accounts receivable and bank accounts. Similarly, various supply/value chain finance arrangements, which have become important mainstream trade finance products catering to the needs of SMEs, are structured around factoring/reverse factoring and outright transfer of receivables."

46. It was agreed that the draft Practice Guide should discuss circumstances where tangible assets were commingled in a mass or were transformed into a product (how arts. 11 and 20 of the Model Law addressed those issues with a cross-reference to paras. 103–106 and 129 of the Guide to Enactment).

47. Subject to the above-mentioned changes (see paras. 33–46 above), the Working Group adopted chapter II.A of the draft Practice Guide.

3. A key preliminary step for secured financing: due diligence (A/CN.9/WG.VI/WP.79/Add.1, paras. 1–29)

48. The Working Group agreed that the term "secured creditor" should be used throughout the draft Practice Guide to the extent possible. It was further agreed that chapter II.B would mention that due diligence would mostly be conducted by lenders, while the contents of that section would be similarly applicable to other types of secured creditors.

49. With respect to paragraphs 1 to 6, the Working Group agreed that:

- The first sentence should be modified to read as follows: "As described in the previous section, the Model Law provides for a simplified legal process for entering into a wide range of secured transactions. While the legal requirements are straightforward, a prudent secured creditor still needs to examine ...";
- Paragraph 1 would mention that due diligence might be required by other laws as also noted in chapter III of the draft Practice Guide and explain that one of

the reasons for conducting due diligence is to gauge whether the debtor would be able to repay the loan;

- The second sentence of paragraph 2 should include as an example, restrictions on enforcement against consumers;
- The last sentence of paragraph 2 should be modified along the following lines: "A secured creditor would need to assess whether there are any competing claims and how to obtain priority over them";
- Paragraph 3 should be deleted;
- Paragraph 5 should briefly explain that the Sample Diligence Certificate provided in the draft Practice Guide is only one example and that the information sought therein would need to be modified depending on the nature of the transaction; and
- Paragraph 6 should clearly distinguish between due diligence (which took place at the outset of a secured transaction) and continued monitoring and further explain that the terms of the monitoring would usually be agreed upon in the security agreement.

Due diligence on the grantor

50. With respect to paragraphs 7 to 9, the Working Group agreed that:

- The final sentence of paragraph 8 should be elaborated to illustrate why a search of any other names of the grantor would be required and the possible consequences, including a cross reference to chapter II.C; and
- Paragraph 9, which provided a summary of the information sought in the Sample Diligence Certificate, should be simplified and the reasons for soliciting such information should be explained in the Sample Diligence Certificate (particularly in relation to other claims as well as preferential claims against the grantor with cross references to the relevant sections of chapter II.G).

Due diligence on the assets to be encumbered

51. With respect to the third sentence of paragraph 10, the Working Group agreed that the words "and their location" should be inserted after the word "existence" and that the words "conflicting security rights or other claims" be replaced with the words "competing claims".

52. With respect to paragraphs 11 to 12, the Working Group agreed that:

- The words "to understand" should be deleted from the second sentence of paragraph 11 and that the sentence should read as follows: "…. necessary for the secured creditor to identify the different types of assets to determine the requirements to be fulfilled to take security over all those assets and to obtain priority";
- The first sentence of paragraph 12 should be revised to state that secured creditors had faced difficulties when the collateral did not exist;
- Paragraph 12 should be rephrased to state that it would only be possible for the secured creditor to verify the existence of present assets and that it might not always be possible to verify the existence of future assets;
- The fifth sentence of paragraph 12 should read along the following lines: "In the case of intellectual property registered in specialized registries, an examination of the documents on file in the relevant registry would allow the secured creditor to verify the existence of and the extent of the intellectual property rights"; and

- The last sentence of paragraph 12 should read along the following lines: “In the case of present receivables, the secured creditor may contact the debtors on the receivables so that they acknowledge that they owe the full amount. In the case of future receivables, the secured creditor may contact potential debtors on the receivables to inquire about the nature of their relationship with the grantor.”

53. With respect to paragraphs 13 and 14, the Working Group agreed that:

- The last sentence of paragraph 13 should be deleted; and

- The last two sentences of paragraph 14 could be revised along the following lines: “In the case of intellectual property registered in specialized registries, the secured creditor can verify the grantor’s rights by examining whether the grantor is identified as the title holder in the relevant registry; for intellectual property licences, the secured creditor can examine the intellectual property licence contract.”

54. With respect to paragraphs 15 and 16, the Working Group agreed that:

- The first sentence of paragraph 15 would read as follows: “A prudent secured creditor would have a good understanding of ...”;

- Paragraph 15 could include an example of artwork as collateral, where its authenticity would need to be verified, and the paragraph should highlight some of the difficulties secured creditors faced when determining the value of assets (particularly in the case of intellectual property) and the existence of different valuation mechanisms, some of which could be costly;

- Paragraph 16 should note that the determined value of the collateral would likely have an impact on the loan to be provided by the secured creditor; and

- The last phrase of the first sentence of paragraph 16 should read: “... that meet its lending criteria (see Chapter III)”.

55. With respect to paragraphs 17 and 18, the Working Group agreed that:

- The following words should be added at the end of the first sentence of paragraph 17: “in the event that the collateral is lost or destroyed”;

- Reference to micro-enterprises in the last sentence of paragraph 17 should be deleted and that sentence would read along the following lines: “… when insurance policies may not be readily available for certain types of asset or when the cost of insurance may be too high”;

- The second sentence of paragraph 18 should read along the following lines: “The secured creditor could also obtain confirmation from the insurer that the insurer would pay any insurance proceeds directly to the lender”; and

- The last sentence of paragraph 18 should be deleted.

56. With respect to paragraphs 19 to 25, the Working Group agreed that:

- The subheading should include a reference to priority competitions;

- The paragraphs should be recast to provide advice to secured creditors upfront;

- Paragraph 20 should be placed after paragraph 23 and further elaborated to note that even in States that have not adopted article 8(e) of the Model Registry Provisions, parties might enter into a priority agreement which sets forth a maximum amount for which the security right could be enforced to facilitate lending by subsequent creditors;

- Paragraph 22 should include cross references to parts of chapters II.C and II.E dealing with specialized registries;

- The first sentence of paragraph 23 should read as follows: "…, it may be prudent for the secured creditor to conduct an additional search of previous owners";
- The second sentence of paragraph 24 should be expanded to illustrate the different circumstances depending on which option in article 38 of the Model Law was enacted and depending on the type of encumbered asset; and
- The last sentence of paragraph 24 should be revised to read: "A search of the Registry would assist the secured creditor to assess whether …".

57. With respect to paragraphs 26 to 28, it was agreed that:

- The draft Practice Guide should use consistent terms to refer to competing security rights or other claims over the assets to be encumbered (for example, "competing claims");
- Paragraphs 26 to 29 should form a separate part of chapter II.B;
- Paragraph 27 should state that the secured creditor may request the grantor to provide a different asset as collateral;
- Paragraph 27 should also note two different scenarios: (i) where the description of assets in the security agreement was broad (in which case, the grantor could request an amendment of the security agreement or a release agreement); and (ii) where the description of assets in the registered notice was broader than that in the security agreement or where there was no security agreement (whereby the grantor could respectively request an amendment or a cancellation notice), including a cross-reference to chapter II.E;
- Words following "a cancellation notice" in the last sentence of paragraph 27 should be deleted;
- In paragraph 28, the first sentence should be simplified, the word "pay-off" in the second sentence removed, and the last two sentences deleted; and
- The end of paragraph 29 should be revised as follows: "… or not enter into the transaction".

58. Subject to the above-mentioned changes (see paras. 51–57 above), the Working Group adopted chapter II.B of the draft Practice Guide.

4. Searching the registry (A/CN.9/WG.VI/WP.79/Add.1, paras. 30–40)

59. As a drafting point to be applied throughout the draft Practice Guide, the Working Group agreed generally that the word "should" would indicate guidance being provided and "must" would indicate that there was a legal obligation.

Why search in the registry?

60. With respect to paragraphs 30 to 34, the Working Group agreed that:

- Paragraph 34 should be placed before paragraph 30 to state the general rule of the Model Law as follows: "Under the Model Law, any person can search the Registry to verify the existence of a security right as long as …";
- That paragraph would briefly explain why a person would conduct a search of the Registry with the following paragraphs illustrating different types of relevant persons that should conduct a search (secured creditors, buyers of tangible as well as intangible asset, judgment creditors, insolvency representatives, judicial officers, unsecured creditors etc.) and reasons for doing so;
- Paragraph 31 and other paragraphs should not give the impression that a mere search would ensure that the rights of the searchers would not be adversely affected;

- The last four sentences of paragraph 32 should be merged with paragraphs 39 and 40 with cross-references to the relevant sections in chapter II.E;

- Paragraph 33 should explain that: (i) a judgment creditor would conduct a search to determine whether there are any unencumbered assets upon which it can enforce; (ii) an insolvency representative would conduct a search to determine whether rights have been made effective through registration and to identify the timing of the registration; and (iii) a person with claims arising by operation of other laws that might have priority over registered security rights would conduct a search to determine whether there were any existing security rights in the assets; and

- An additional paragraph should illustrate when a search should be conducted, which could include references to some grace periods provided under the Model Law for registration.

How to search in the registry?

61. With respect to paragraphs 35 to 40, the Working Group agreed that:

- The first sentence of paragraph 35 should read: “Searches of the Registry are conducted using the name of the grantor”;

- Paragraph 36 should be modified along the following lines: “Searchers are responsible for using the correct name when conducting searches. A searcher should not rely on business or trade names, as they may be different from the grantor’s correct name. The correct name is determined by reference to official documents or public record as specified by the enacting State (art. 9 of the Model Registry Provisions). Therefore, before conducting a search of the Registry, a searcher should obtain a copy of the specified official document from individual grantors or conduct a search of public business records if the grantor were a legal person. Individuals may be hesitant in providing their official documents (for example, to their judgment creditors). In such a case, searches should be conducted with all conceivable names of individuals”;

- Paragraph 37 should present the exact and close match systems neutrally and its last sentence deleted;

- Paragraph 38 should be revised along the following lines: “Under both options, searchers should determine whether the name in the search result relates to the relevant grantor and whether the search result reveals assets which are relevant for the proposed transaction or for any other reason”;

- Paragraphs 39 and 40 (as well as parts of para. 32) should form a separate part with the subheading “Situations where a single search using the current name of the grantor may not be sufficient”, which would address the following circumstances: (i) where the grantor recently changed its name; (ii) where the asset was recently transferred; and (iii) where the asset acquired might be subject to an acquisition security right which was not yet registered;

- With regard to the first circumstance mentioned above, it should be explained that a secured creditor that registered a notice under the old name would retain its priority if it registered an amendment notice within the period specified (art. 25 of the Model Registry Provisions), thus requiring the searcher to conduct an additional search; and

- There was no need to include in the draft Practice Guide the sample search request form or the sample search result form contained in the Registry Guide.

62. Subject to the above-mentioned changes (see paras. 59–61 above), the Working Group adopted chapter II.C of the draft Practice Guide.

5. Preparing the security agreement (A/CN.9/WG.VI/WP.79/Add.1, paras. 41–55)

63. As a general point, it was agreed that additional subheadings should be inserted in chapter II.D (as well as in other parts of the draft Practice Guide) to set forth the issues discussed in the paragraphs more clearly.

64. With respect to paragraph 41, the Working Group agreed that:

- The phrase "for non-security purposes" in the second sentence should be deleted; and
- The last sentence should form a separate paragraph providing a brief introduction to the sample security agreement(s) (which covered assets owned by the grantor) and the sample retention-of-title clause(s) provided in the annexes.

Legal requirements for a security agreement

65. With respect to paragraphs 42 to 46, the Working Group agreed that:

- Paragraph 42 should explain that "writing" included electronic communication (art. 2 (*nn*) of the Model Law); and
- Paragraph 44 should be simplified by making reference to the relevant examples provided in chapter II.A with regard to different types of assets and the second sentence could be revised along the following lines: "When a grantor wishes to grant a security right over all its assets, it would be sufficient for the secured creditor to describe the assets as 'all present and future assets'".

Practical considerations

66. With respect to paragraphs 47 to 55, the Working Group agreed that:

- The heading to those paragraphs should be revised along the lines of "Other items that could be included in the security agreement";
- The last sentence of paragraph 47 should be deleted;
- The phrase "or other applicable law of the enacting State" should be added before the parentheses in the last sentence of paragraph 49; and
- In paragraph 54, the fourth sentence should read as follows: "..., it is more likely that similar clauses would be included in the sales agreement itself" and an addition example involving assets used in the manufacturing process should be included in that paragraph.

67. Subject to the above-mentioned changes (see paras. 63–66 above), the Working Group adopted chapter II.D of the draft Practice Guide.

C. The interaction between the Model Law and the prudential regulatory framework (A/CN.9/WG.VI/WP.79/Add.3, paras. 1–25)

68. In considering chapter III of the draft Practice Guide, the Working Group welcomed the efforts by the Secretariat to coordinate with the BCBS and considered comments received from its secretariat.

1. Introduction (A/CN.9/WG.VI/WP.79/Add.3, paras. 1–8)

69. With respect to paragraphs 1 to 8, the Working Group agreed that:

- In paragraph 3, the word "hold" should be changed to "maintain" in the second sentence and the following two sentences be shortened as follows: "Capital adequacy standards typically define specific requirements to cover operational risk, market risk and credit risk, with the focus on credit risk";

- The third, fourth and fifth sentences of paragraph 4 should be revised as follows: “Minimum regulatory capital requirements are expressed as a ratio of: (i) the financial institution’s own funds, primarily composed of shareholders’ equity and long term subordinated debt; (ii) the risk-weighted assets of the financial institution. Hence, the required amount of capital is not fixed in absolute terms, but is set relative to both the balance sheet size of the regulated financial institution and the riskiness of its assets. In practice, for every financing transaction, like an extension of a loan, regulated financial institutions calculate a capital charge that reflects the level of risk of that transaction (in particular, credit risk)”;

- In the first sentence of paragraph 5, the phrase “provide for capital adequacy ratios” should be changed to “set the capital adequacy ratios that financial institutions must meet” and the words “new” qualifying loans in that paragraph deleted; and

- The first sentence of paragraph 7 should read as follows: “… is coordinated and respects globally agreed minimum standards.”

2. Key terminology (A/CN.9/WG.VI/WP.79/Add.3, para. 9)

70. With respect to paragraph 9, the Working Group agreed to:

- Reiterate the intended audience of chapter III;

- Mention that the definitions provided in this section might not be in line with those of BCBS;

- Include a sentence that the terminology and definitions set forth in this section were to assist the readers in better understanding section C; and

- Include the phrase “, subject to certain conditions being met” at the end of the definition of eligible collateral.

3. Enhancing coordination between the Model Law and national prudential regulation (A/CN.9/WG.VI/WP.79/Add.3, paras. 10–25)

71. With respect to paragraphs 10 to 25, the Working Group agreed that:

- In paragraph 10, the word “incentivize” should be changed to “, in turn, enable”;

- In paragraph 11, the last two sentences should be amended as follows: “However, the lack of coordination between capital requirements and the Model Law could inadvertently limit incentives that regulated financial institutions have to extend credit secured with rights over certain movable assets. In addition, and as further illustrated in this Chapter, certain movable assets, such as receivables, inventory, or equipment, might not necessarily qualify as eligible collateral, and the loans would therefore be treated as unsecured for prudential regulatory purposes”;

- In the fourth sentence of paragraph 13, reference should be made to article 35 of the Model Law instead of recommendation 239 of the Legislative Guide;

- In paragraph 16, the fourth sentence should read “Rights of regulated financial institutions to reimbursement of their undertaking in the form of commercial letters of credit might also reduce capital charges if certain conditions are met”; the fifth sentence deleted; and the phrase “that usually encompass the borrowing base” in the sixth sentence deleted;

- At the end of paragraph 17, the following phrase “and have sufficient and reliable historical data” should be added;

- The penultimate sentence of paragraph 21 should be modified as follows: “Moreover, national regulatory authorities ordinarily require financial

institutions using internal models to indicate the types of physical assets that would be accepted as collateral and to establish…"; and

- The phrase "eligible collateral" in the first sentence of paragraph 22 should be replaced by "different classes of collateral."

72. Subject to the above-mentioned changes (see paras. ... above), the Working Group adopted chapter III of the draft Practice Guide.

D. Annexes to the draft Practice Guide (A/CN.9/WG.VI/WP.79/Add.1 and A/CN.9/WG.VI/WP.79/Add.3)

73. With regard to annex I (Sample Diligence Certificate), it was agreed that:

- The term "questionnaire" should be used instead of the term "certificate";
- The introductory paragraph should emphasize that the Sample Diligence Certificate would need to be adapted depending on the nature of the parties and transactions involved, and include a sentence along the following lines: "While the Sample Diligence Questionnaire solicits a wide range of information required for more sophisticated types of secured transactions, the actual questionnaire that would be used for more general types of secured transactions could be extensively simplified (for example when a micro-enterprise was the grantor)";
- Throughout the draft Practice Guide, examples should not use terms which were jurisdiction-specific (for example, with regard to corporate forms);
- The Sample Diligence Certificate and other sample documents should contain blank fields rather than names of parties; and
- The Sample Diligence Certificate and other sample documents should be placed at the end of the draft Practice Guide as an annex.

74. With respect to annex II (Sample Security Agreement), the Working Group agreed that:

- An introductory paragraph should be added indicating that not all of the provisions in the sample agreement might be valid under other applicable laws of the enacting State;
- Definitions should be incorporated into the body of the sample agreement to the extent possible;
- An additional sample security agreement relating to a single tangible asset should be prepared, which could include the minimum content required under the Model Law with few additional clauses (for example, clauses on continued monitoring);
- Footnote 8 should be clarified that the information contained in section 3 of the sample security agreement would only "assist" the secured creditor in determining where registration was to be made; and
- Footnote 10 should be deleted.

75. With respect to annex III (Sample retention-of-title clause), the Working Group agreed to delete the fourth clause, which restated the provision of the Model Law.

76. The Working Group considered annex IV (Glossary) and agreed that:

- The last sentence of the introductory paragraph should be deleted;
- The terms should be retained in the current alphabetical order;
- Whether the glossary should contain a definition of "borrowing base" would need to be considered after the Working Group had considered the entirety of the draft Practice Guide;

- The term “possession” and its definition should be deleted as it merely replicated the definition in the Model Law (art. 2(z)) and did not provide further guidance;

- Changes suggested with regard to the definitions of the terms “acquisition security right”, “debtor”, “default”, “movable asset”, “proceeds”, “priority”, “secured creditor”, “security agreement” as well as “security right” should be made.

77. Subject to the above-mentioned changes, the Working Group adopted annexes I, II, III and IV in document A/CN.9/WG.VI/WP.79/Add.1 and also adopted the annex (The Model Law and work by UNCITRAL in the area of secured transactions) in document A/CN.9/WG.VI/WP.79/Add.3 unchanged.

E. Consideration of chapters II.E to II.J of the draft Practice Guide (A/CN.9/WG.VI/WP.79/Add.2)

78. After considering and adopting the contents of the draft Practice Guide contained in documents A/CN.9/WG.VI/WP.79, A/CN.9/WG.VI/WP.79/Add.1 and A/CN.9/WG.VI/WP.79/Add.3, the Working Group engaged in a discussion on how to progress on its work to submit a final draft of the Practice Guide to the Commission at its fifty-second session.

79. It was noted that the remaining time available at this session would not be sufficient to adopt the contents of document A/CN.9/WG.VI/WP.79/Add.2, which contained chapters II.E to II.J of the draft Practice Guide. Thus, it was agreed that the Secretariat would be tasked with preparing the final draft of those chapters for submission to the Commission.

80. During the discussion, it was suggested that the Commission should be provided ample time to finalize and adopt the draft Practice Guide, while it was also suggested that due consideration should be given to other agenda items at that session.

81. To ensure that all comments would be reflected in the draft to be prepared by the Secretariat, it was agreed that remainder of this session would be devoted to providing inputs to chapters II.E to II.J of the draft Practice Guide without taking any decision. It was also agreed that additional comments could be submitted to the Secretariat in any official language of the United Nations after the session. The Secretariat was requested to prepare the draft Practice Guide reflecting those comments for consideration by States as early as possible.

82. On that basis, the Working Group continued its discussion and gathered comment with regard to chapters II.E to II.J of the draft Practice Guide.