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Registration of security rights in movable assets

Note by the Secretariat

Addendum

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IV. Legal rules applicable to the registration and search process

A. Introduction

1. In the interest of legal certainty, a State establishing a security rights registry will need to develop a set of legal rules and forms to govern the registration and search process. The goal of this chapter is to identify the issues that the Working Group may wish to address in a text on registration of security rights in movable assets. The recommendations of the *Guide* (in particular, chapter IV) provide the foundation for the treatment of these issues. Accordingly, this discussion is based on those recommendations and they are referred to throughout this note.

B. Entitlement to register

2. Usually the secured creditor is entitled to effect a registration with respect to its security right, directly or through an agent such as a law firm, intermediary or other service provider (once a registry is established these service providers create a new business, which is an additional benefit of reform, that facilitates job creation and new economic development activities). In some common law systems, however, the company-grantor is actually the only one that is permitted to register security rights (“charges”) in the company registry.

3. Similarly, usually the initial registrant may cancel or amend a registration. If a personal identification number is assigned by the registry to the initial registrant, any person in control of the number may register a cancellation or amendment.

4. Secured transactions laws often require grantor authorization for the secured creditor to register information relating to a security right (the *Guide* refers to registration of a “notice”). However, this requirement typically may be satisfied by an agreement (entered into before or after the security agreement itself is entered into) that does not need to be included in the registered information. In addition, the security agreement in itself is often considered to be sufficient authorization for registration. This is the approach recommended in the *Guide* (see the *Guide*, recommendation 71). With the development of electronic communications, grantor authorization is less of a problem as the grantor may include its authorization in the registry record in advance or the registry record may automatically request it upon registration by the registrant.

5. In contrast, some registry systems require the grantor’s consent to be evidenced on the registry record itself. For example, this is the approach recommended in the European DCFR. This requirement adds considerable cost and time to the registration process since it requires reliable verification of the fact that the person giving consent is in fact the grantor named in the registration. Grantor identification may not be a problem if the grantor may be identified with a unique number (as in the case of registered companies or grantor with a number identification card), but is a real problem with respect to other types of grantor.

6. Systems that require the grantor’s authorization to appear on the record may be influenced by an inappropriate analogy with title registries. In a title registry, such a requirement makes sense insofar as the rights of the true owner may be lost if an unauthorized transfer is entered on the record and the person named as the new

owner then proceeds to dispose of the asset. However, in a security rights registry, registration merely provides notice of the possible existence of a security right in the described assets. This is prejudicial to the person named as grantor in the registration only insofar as it impedes that person's ability to deal freely with the assets described in the registration until the registration is cancelled.

7. Accordingly, the problem of unauthorized registrations can more efficiently be dealt with by establishing a summary procedure to enable a person named as grantor in an unauthorized registration to quickly and inexpensively cancel or amend an unauthorized registration (see the *Guide*, recommendations 54, subparagraph (d), and 72). Such a procedure is dealt with later in this chapter (see paras. 55-59 below). Additional security against unauthorized registrations can also be achieved by incorporating some form of registrant identification into the registration process. That way, the system has a record of the responsible party (see paras. 73-76 below). An additional way to minimize the unauthorized registrations is to require that the registrant notify the grantor of an initial registration and the registry notify the grantor of any subsequent changes (see the *Guide*, recommendation 55, subparas. (c) and (d)).

C. Advance registration

8. Modern registry systems typically provide for advance registration, that is, registration made before a security agreement between the grantor and the creditor is concluded or a security right has come into existence (see the *Guide*, recommendation 67). Advance registration enables a potential secured creditor to establish a first-ranking priority position against subsequently registered security rights at an early stage in the negotiations with the potential grantor. This in turn eliminates the delay in extending credit to the grantor that would otherwise result if registration could be made only after the security agreement had been concluded.

9. If the negotiations are aborted and no security agreement is ever entered into between the parties named in the registration, the creditworthiness of the person named as grantor in the registration may be adversely affected. This risk, like the risk of unauthorized registrations generally, can be controlled by ensuring that: (a) the grantor would be notified in a timely manner about the registration (see the *Guide*, recommendation 55, subpara. (c)); and (b) the grantor could compel the cancellation of the registration through a summary procedure (see the *Guide*, recommendations 54, subpara. (d), and 72 and paras. 55-59 below).

D. One registration for multiple security agreements

10. In a modern registry system (in which what is registered does not include the security documentation), a single registration is sufficient to give third-party effectiveness to security rights arising under successive or amended security agreements between the same parties that involve the same encumbered assets (see the *Guide*, recommendation 68). In such a case, the registration is effective only to the extent the registered information reflects the new or amended security agreements. For example, if a new security agreement covered assets not described in the prior registration, a new registration would be needed.

11. The advantages of a system which permits a single registration to relate to multiple security agreements include: (a) reduced registration costs; (b) reduced priority risk for secured creditors; and (c) greater flexibility for grantors and secured creditors to adjust their lending relationship as circumstances evolve.

E. Required content of registration

1. Grantor information

(a) General

12. Inasmuch as only certain types of encumbered asset have a serial number or a similar identifier, in modern secured transactions and registration regimes, the grantor's name or other identifier is the main available criterion for searching the records of a security rights registry in order to discover all information registered with respect to security rights that may have been created by a particular grantor in most types of asset. As such, the rules applicable to registration make it clear that inclusion of this information is an essential component of an effective registration. The grantor's address should also be included, both to assist in grantor identification, and to enable interested parties to communicate with the grantor for the purposes of obtaining further information or to send legal notices.

13. In some registry systems, the grantor's address does not need to be included in the registration. This is due to privacy concerns. Thus, interested parties are required to contact the secured creditor and obtain further information about the grantor. In addition, those potential third-party financiers are likely to already be in contact with the grantor. It should be noted that, if the required grantor identifier is reliable and unique (for example, a national identification number), the grantor's address may not be really essential, because: (a) with a unique identification number, the address is not needed to identify the grantor; (b) a potential creditor presumably knows how to reach the potential grantor and obtain the necessary information; and (c) a potential creditor will need to contact the secured creditor on record in any case to confirm any information provided by the grantor.

14. The grantor may have created a security right in its rights to secure an obligation owed by a third-party debtor. Since the object of registration is to disclose the possible existence of a security right in the asset described in the registration, the rules typically provide that the person whose name must appear on the registration is the grantor, not the third-party debtor (or a mere guarantor of the obligation owed by the third-party debtor).

15. To provide legal certainty for registrants and third-party searchers, modern registration regimes also provide explicit guidance on what constitutes a valid grantor identifier. Otherwise, a secured creditor cannot be confident that its registration will be effective and searchers cannot confidently rely on a search result (see the *Guide*, recommendations 58-60).

(b) Individual versus enterprise grantors

16. A modern registry system is usually designed to allow registration of information affecting enterprise and individual grantors in a manner that permits the system to identify which grantors are individuals and which are enterprises

(separate data fields for registration purposes and separate databases for storage purposes). This design feature recognizes that different identifier rules will be required for the two categories of grantors. It also enhances the efficiency of the search process. For example, the search logic for enterprise grantors can utilize normalized versions of the enterprise name that, in sequence: (a) remove all punctuation, special characters and case differences; (b) concatenate groups of free-standing characters; (c) remove selected words or abbreviations that do not make a name unique (such as articles of speech and indicia of the type of enterprise such as “company”, “partnership” “LLC” and “SA”); and (d) concatenate the resulting words into a character string for comparison with the normalized versions of names in the index.

17. This design feature has implications for the rules applicable to the registration and searching process. Modern registration regimes make it clear that an effective registration requires registration of the grantor name (first name, middle name and last name) in the appropriate fields. It is critical that registry users understand the importance of accuracy in this respect, since a search of the individual grantor database would not disclose a security right registered against an enterprise grantor, and the converse is also true.

(c) Individual grantor identifier

18. Some registry systems designate a government issued identification number as the required identifier for individual grantors, while other systems use the name of the grantor (see the *Guide*, recommendation 59).

19. Whether a government issued identification number is a suitable identifier depends on two principal considerations. First, whether the public policy of the State (for example, privacy or security concerns) prevents the use of identification numbers for legal purposes other than that for which the number was issued. If that is not the case, the next question is whether the system under which the numbers are issued is sufficiently reliable to ensure that each individual is assigned a unique number.

20. If the grantor’s name must instead be used as the relevant identifier, it is important to have clear rules specifying what constitutes the grantor’s “legal” name and what components of the name are required (for example, surname, first given name, middle initials). These rules are needed even when a State-issued identification number is the general grantor identifier if the grantor is not a citizen or resident of the State and therefore has not been issued an identification number. The following three approaches may be envisaged: (a) all grantors may be identified by a number; (b) all grantors may be identified by a name; and (c) some grantors (citizens) may be identified by a number and some (non-citizens) by a name. Ideally, all grantors should be identified by a number.

21. While the rules for the legal name of the grantor depend on the general naming conventions of each State, often reliance is placed on State-issued documentary sources. A rule incorporating this approach might, for example, provide for alternative sources in order to accommodate the particular circumstances of different grantors (including a change of circumstances as, for example, where at a certain time a grantor has only a foreign passport, but later obtains the citizenship and identification card of the State of the registry):

| Grantor Status | Documentary Source of Name |
|---|--|
| Born in enacting State | Birth certificate |
| Born in enacting State but birth not registered in enacting State | (1) Current passport; (2) If no passport, current social insurance/social security card; (3) If no passport or card, current foreign passport from jurisdiction of habitual residence |
| Born in enacting State but birth name subsequently changed pursuant to change of name legislation | Name as it appears on change of name certificate or equivalent document (such as a marriage certificate) |
| Naturalized citizen of enacting State | Citizenship certificate |
| Not born in enacting State and not a citizen of enacting State | (1) Current foreign passport issued by the jurisdiction whose citizenship the grantor has; (2) If no current foreign passport, current visa issued by enacting State; (3) If no visa and no foreign passport, governmental birth certificate issued at grantor's birth place |
| None of the above | Name as it appears on any two documents issued by the enacting State, if those names are the same (for example, a current motor vehicle operator's licence and a current government medical insurance identification card) |

22. In jurisdictions where a certain name is a very common one shared by many individuals, there may be a benefit to requiring additional information, for example, date of birth in order to permit closer identification of the grantor. So, where a search result discloses many grantors having the same surname, the given names and the addresses associated with each grantor may assist third parties to determine which if any of the grantors is the one in which they are interested. There is on the other hand, the need for restraint in demanding supplementary information since the more detail that is required to be included, the greater the risk of registrant error and the greater the privacy concerns (see the *Guide*, recommendation 59).

(d) Enterprise grantor identifiers

23. To determine the correct identifier for enterprise grantors, modern registration regimes often first designate the types of entity that are to be considered enterprises for the purposes of registration. In addition to legal persons such as corporations, the list includes unincorporated entities with a legal identity separate from that of its owners (such as partnerships, syndicates and joint ventures, trade unions, trusts, and estates of deceased or insolvent persons).

24. The relevant rules also provide guidance on what constitutes the legal name or other identifier of the entity for registration purposes. For corporations and other entities whose organization is required to be established and disclosed in a public record, the name set out in that record is used (or the registration number of the entity in a company registration or similar record). For other entities that do not have a separate legal identity from that of its owners, such as unregistered partnerships, reliance usually is placed on the name set out in the instrument constituting the entity (see the *Guide*, recommendation 60). However, third parties may not have access to that instrument and it may be desirable to require inclusion of additional grantor identifiers, for example, the entry in the individual grantor field of the identifiers of the partners of an unregistered partnership.

25. Where a syndicate or joint venture is the grantor, the names of all of the participants in the syndicate or joint venture or a person or corporation appointed to act for the syndicate or joint venture are normally entered. Where a trade union is involved, the grantor identifier would typically be the official name of the trade union; where a trust is involved, it would be the name(s) of the trustee(s); where an estate of a deceased is involved, it would be the name of the estate administrator identified as such; and where an insolvent debtor's estate is involved, it would be the name of the insolvency representative.

26. In the case of sole proprietorships, even though the business may be operated under a different business name and style other than that of the proprietor, registry rules typically require entry of the proprietor's name or other identifier in accordance with the rules applicable to individual grantors (because it is the individual that is the grantor) in addition to entry of the name of the business in the enterprise grantor field. It should be noted that, in some States, most types of legal entity have a registration or other unique number and thus their identification for registration purposes is simplified.

(e) Impact of error in grantor identifier on the effectiveness of registration

27. Since the grantor's name or other identifier is the search criterion for retrieving notices, modern registration regimes provide guidance on the circumstances in which an error in the identifier that was entered will render a registration ineffective with the result that third-party effectiveness of the security right is not achieved. The relevant rules make it clear that the test is not whether the error appears to be minor or trivial in the abstract but whether it would cause the registration not to be retrieved during an official search of the record (that is, not a random search or a search of the service provider records) using the legal grantor identifier. It should also be made clear that the test is an objective one, that is to say, the person challenging the effectiveness of the registration should not have to show that it suffered any actual prejudice as a result of the error (see the *Guide*, recommendation 58). The rules by which the record may be searched should be published in a regulation or other authoritative publication on which users can rely.

28. In some registry systems, software is used that returns close matches to the correct grantor identifier. Such systems may allow a registration to be considered effective even though the registrant has made a minor error in entering the grantor identifier so long as the searcher would consider it likely that the grantor whose name appears on the search result as an inexact match is nonetheless the relevant grantor. Whether this is the case depends on such factors as how long the list of

inexact matches is and whether a searcher would be able to readily identify the correct grantor by referring to other information, such as address and first name (a searcher after all should not have to chase down many grantors that may or may not be the relevant one).

2. Secured creditor information

29. The rules and forms applicable to the registration process invariably require entry of the identifier of the secured creditor, or the secured creditor's representative, along with its address. The applicable identifier rules should be the same as for the grantor. There may be one exception to this approach. Whereas a numeric identifier for the grantor should be known by the registrant and a searcher, that may not be necessarily true of the secured creditor's numeric identifier. The purpose of providing information on the secured creditor is to permit a searcher to make further inquiries if it is considering extending credit secured by the encumbered asset. Therefore, the name may be the only appropriate identifier for the secured creditor or its representative. In any case, since the secured creditor identifier is not a search criterion or an element that determines the effectiveness of registration, accuracy is not as essential to the effectiveness of the registration. Substantial accuracy is still important as a practical matter since searchers will rely on the registry record for the purposes of communicating with the secured creditor to obtain further information concerning the security agreement underlying the registration or for sending legal notices (see the *Guide*, recommendation 64). Accordingly, a registration that states the name or other identifier of the secured creditor with substantial accuracy should be sufficient even though the standard is higher with respect to the name or identifier of the grantor.

3. Description of encumbered assets

(a) General

30. It is important to include in a registration a description of the encumbered assets. The absence of a description would limit the grantor's ability to sell its encumbered assets or create security rights in them. Prospective buyers and secured creditors would require some form of protection (for example, a release from the secured creditor) before entering into transactions involving any of the grantor's assets. The absence of a description would also diminish the information value of the registry record for insolvency representatives and judgment creditors. For these reasons, a description of the encumbered assets is invariably a mandatory component of registration (see the *Guide*, recommendations 57, subparagraph (b)).

31. A description of an encumbered asset is generally considered sufficient, for the purposes of both the security agreement and registration, as long as it reasonably identifies the assets encumbered by the security right (see the *Guide*, recommendation 63). Where the security right covers generic or sub-generic categories of a grantor's assets, registration rules often explicitly state that a description of the relevant category is sufficient, for example, "all of the grantor's movable assets" or "all of the grantor's inventory and receivables." The rules also provide that such a description is assumed to cover future assets within the relevant category unless expressly stated otherwise. For example, a reference to "receivables" would include both present and future receivables.

32. A registration may sometimes include a description of a type of asset (for example, through an online drop-down menu of types of asset) even though the security agreement to which the agreement relates covers only certain specific items within the relevant category. For example, the registration may describe the encumbered assets as “all tangible assets” whereas the security agreement creates a security right only in certain specifically described items of equipment. This approach enables the secured creditor to enter into new security agreements encumbering additional assets as the grantor’s financing needs evolve while still being able to rely on the existing registration for third-party effectiveness and priority purposes. However, to address situations where the grantor has not authorized a description in a registration that is broader than the actual range of assets in which a security right has been created or is contemplated, modern secured transactions and registration regimes typically provide that: (a) the secured creditor has to appropriately amend the registration shortly after receipt of the grantor’s request; (b) the grantor is entitled to seek an appropriate amendment through a summary judicial or administrative procedure (see the *Guide*, recommendations 54, subparagraph (d), and 72).

(b) Description of serial number assets

33. Many modern registry systems allow asset-based searching for specific types of asset that have a reliable serial number or similar identifier, and have clear rules for determining the relevant asset identifier (for example, motor vehicles licensed for use on the public roads, major items of industrial, agricultural or construction equipment or household equipment). As in such systems the serial number constitutes an additional search criterion, there is an additional obligation on registrants to enter the serial number in the registration space or field designated specifically for serial number descriptions. Some registration regimes provide that third-party effectiveness against other secured creditors can be achieved without entering the serial number, but to protect against buyers, the serial number must be indexed. The rationale is that a buyer does not have access to all of the information that a secured creditor will have in the course of its due diligence, so it needs the serial number to be sure that title is clear before agreeing to buy.

34. Serial number registration limits the ability of a secured creditor to make a security right effective against third parties in future serial number assets through a single registration. A new registration will have to be made (or the existing registration would need to be amended) to record the serial number of each new item as it is acquired by the grantor (unless future serial numbers are known before production of the assets and the registration system permits registration of multiple serial numbers). It is important, therefore, that the rules also confirm that a serial number description is not required where the serial number assets are held by the grantor as inventory. For the following reasons, serial number identification of inventory is unnecessary to protect third parties. First, buyers that acquire inventory from the grantor in the ordinary course of the grantor’s business take the inventory free of the security right in any event (see A/CN.9/WG.VI/WP.44, paras. 39-41). Second, a generic description of encumbered assets simply as “inventory” is sufficient to enable third-party secured and unsecured creditors to reasonably identify the encumbered assets.

35. Where there are several acceptable serial numbers for specific assets, there should be clear rules as to which serial number should be included in a registration and those rules should also apply to searches. For example, in some States, a motor vehicle can be described by a Vehicle Identification Number (VIN), assigned in accordance with the national Motor Vehicle Standards Act; if there is no VIN, the chassis number can be entered; if there is no VIN or chassis number, the manufacturer's number can be entered. In those States, a searcher has to search first against the VIN, and only if the VIN is not found, should a searcher refer to the next relevant number.

(c) Description of proceeds

36. In the event that the encumbered assets are disposed of by the grantor, the underlying secured transactions law typically allows the secured creditor to claim an automatic security right in the proceeds of disposition.

37. When the proceeds described in a generic way in the registration consist of money or a right to payment, modern secured transaction and registration regimes generally provide for automatic continuation of third-party effectiveness of the security right in such proceeds. However, where the proceeds are not money or a right to payment and are not otherwise encompassed in the indication of encumbered assets in the existing registration, the security right in the proceeds is effective without registration of an amendment for a short fixed period of time after the proceeds arise. If an amendment is registered within that period, third-party effectiveness will be continuous from the date of the initial registration (see the *Guide*, recommendations 39 and 40). An amendment of the registration is necessary in such cases because simply including a general reference to "proceeds" in the registration would not be sufficient, since it would not enable a third party to identify which categories of assets in the grantor's possession might constitute the relevant proceeds. Where this is the case, the rules applicable to registration make it clear that the same description requirements that apply to the original encumbered assets also apply to the proceeds.

38. In some modern registry systems where registration takes place online, the term "proceeds" has as default value the broadest possible description "all present and future assets". This default proceeds description can be overwritten by the registrant.

(d) Impact of erroneous or insufficient asset description on the effectiveness of registration

(i) General

39. A registrant's failure to describe an asset in a registration means that the registration is ineffective to the extent of the omission with the result that the security right in that asset is not effective against third parties (this rule applies also to proceeds subject to the qualifications discussed in para. 37 above). However, modern secured transactions and registration regimes make it clear that the registration is ineffective only to the extent of the omitted assets and that the security right is still effective against third parties with respect to the encumbered assets that were described in the registration (see the *Guide*, recommendation 65).

40. Unlike the grantor's name, the description of the encumbered assets is not a search criterion (with the exception of serial number of assets; see paras. 33-35 above; see also paras. 41, 42 and 63 below). Consequently, modern secured transactions and registration regimes normally clarify that a minor error in the description of the encumbered asset does not make the registration ineffective so long as a reasonable searcher would nonetheless conclude that the description covers the relevant item or kind of encumbered asset (see the *Guide*, recommendation 64).

(ii) *Error in the description of serial number assets*

41. In systems that provide for supplementary asset-based registration and searching for certain serial number assets, the test for whether an error renders a registration ineffective should be the same as for an error in the grantor identifier, that is, whether the error would cause the registration not to be retrieved on a search using the correct number.

42. Guidance is also given on the result where the serial number is correctly entered in the registry, but there is an error in the grantor identifier sufficient that the registration would not be retrieved using the grantor identifier as the search criterion. In principle, a third-party searcher should be entitled to place full confidence in either a grantor or a serial number search. However, not all searchers will necessarily have ready access to the serial number of particular assets of the grantor. In addition, the imposition of what effectively would be mandatory serial number searching might result in excessive cost and inconvenience for searchers, for example, where the grantor holds many items that qualify as serial number assets. Consequently, the rules should specify that an error in the serial number makes the registration ineffective if it would cause the registration not to be retrieved using the serial number search criterion even if the grantor identifier is correctly entered (see the *Guide*, recommendation 63). It should be noted that, in some registration regimes, a buyer may rely on either the identifier of the grantor or the serial number of the asset, while a potential secured creditor may rely only on a search according to the grantor's name or other identifier.

4. Duration of registration

43. Two approaches to the duration of a registration are possible (see the *Guide*, recommendation 69). First, the secured transactions law could specify that all registrations are subject to a standard statutory term (for example, five years) with the obligation then being cast on the secured creditor to ensure that the registration is renewed before the expiry of that term. Alternatively, the law may permit secured creditors to self-select the desired term of the registration. In the latter event, entry of the relevant term will be a legally essential component of an effective registration. In systems that adopt this second approach, it may be desirable to base registration fees on a sliding tariff related to the length of the registration life selected by the registrant in order to discourage the selection of excessive registration terms. It may also be desirable to design the system in a way that would not permit registration for too short a period of time (for example, two weeks) or clear the record automatically to avoid registrations that never expire. It should be noted, however, that modern registration regimes typically provide that an error in

the duration of the registration does not render the registration ineffective (see the *Guide*, recommendation 66).

5. Maximum amount of secured obligation

44. Some secured transactions and registration regimes require a registrant to include a statement of the maximum amount of indebtedness secured by the security right (this is a possibility left open in the *Guide*; see recommendation 57, subparagraph (d)). As a result, the security right is not effective against third parties with respect to any amounts exceeding the maximum amount of the secured creditor (in any case, the secured creditor cannot claim more than it is actually owed for capital, interests and any agreed expenses). The aim of this requirement is to facilitate access to additional sources of secured financing by the grantor based on the residual value of the asset over and above what is needed to satisfy the obligation secured by the earlier registered security right.

45. The parties are always free to agree to a maximum sum that is sufficiently high to accommodate any foreseeable need for a later increase in the value of the secured obligation. However, if the secured creditor has sufficient bargaining power as against the grantor to insist on stating an inflated estimate, the objective of the requirement is undermined. In any event, where this approach is adopted, entry of the relevant amount will be an essential component of an effective registration. It should be noted, however, that, as in the case of errors in the duration of registration, modern registration regimes typically provide that an error in the maximum amount of the secured obligation does not render the registration ineffective (see the *Guide*, recommendation 66). It should also be noted that the inclusion of the maximum amount of the obligation secured in the registration information raises other issues of confidentiality and competition.

F. Registration of subsequent changes

1. Transfer of a security right

46. If a secured creditor transfers a security right made effective against third parties by registration, it should not be mandatory to update the registration to reflect the name of the new secured creditor since the relevant search criterion is the grantor identifier, not the secured creditor identifier. However, entry of such an amendment should be possible since the original secured creditor will usually not wish to have to continue to deal with requests for information from third-party searchers and since the new secured creditor will wish to ensure that it receives any legal notices or other communications relating to its security right (see the *Guide*, recommendation 75). In addition, the original secured creditor should be under a legal obligation to disclose the new secured creditor's identity to at least the grantor in order for the grantor to be able to obtain current information relating to the registered security right and the obligation to which it relates.

2. Subordination of priority

47. Where a secured creditor agrees to subordinate a registered security right to the right of another secured creditor, the secured creditor should be entitled to amend the registration to disclose the subordination. However, disclosure should be

optional to the extent that the subordination only affects the relative priority position of the subordinating secured creditor and the beneficiary of the subordination (see the *Guide*, recommendation 94).

3. Change in grantor identifier or transfer of encumbered asset

48. A change in the name or other identifier of the grantor, or the transfer by the grantor of its right in the encumbered asset may undermine the publicity function of registration. The grantor's identifier is the principal search criterion and a search using the grantor's new identifier or the identifier of the grantor's transferee will not disclose a right registered against the old identifier or the identifier of the original grantor.

49. States take varying approaches to the issue of whether and when a secured creditor should have to amend a registration in these circumstances. To the extent disclosure is required, modern registration regimes provide guidance provided on what constitutes a change of identifier in the context, in particular, of corporate amalgamations and the effect of not making an amendment in these circumstances (see the *Guide*, recommendation 61).

4. Addition of new encumbered assets

50. After the conclusion of the original security agreement, the grantor may agree to grant a security right in additional assets not already described in the security agreement. In such a case, the question arises whether a new registration would be required or whether the addition could be made by amending the original registration. If the latter option is chosen, modern registration regimes make it clear that the security right in the additional assets takes effect against third parties and acquires priority status only from the time of registration of the amendment (see the *Guide*, recommendations 70 and 73).

5. Continuation

51. Modern registration regimes provide that the duration of an existing registration may be extended by way of amendment at any time before the expiry of the term of the initial registration so as to avoid a lapse of the initial third-party effectiveness. If a new registration were instead required this would undermine the secured creditor's original priority status and the continuity of the effectiveness of its security right against third parties. As with regard to the initial duration of the registration, the term for which a registrant may continue a registration may be set in the law or selected by the registrant. If the duration is set in the law, the extension period should be equal with the initial period. If the law permits the registrant to select the duration of the registration, the extension period would be the one selected by the registrant. In the latter case, a registrant may select, for example, five years for the initial registration and three years for the continuation (see the *Guide*, recommendation 69).

6. Correction of erroneous lapse or cancellation

52. In the event that a secured creditor fails to renew a registration in a timely fashion or inadvertently registers a cancellation, some systems permit the secured creditor to revive its registration at any time. In such a case, the effectiveness of

registration is reinstated as of the time it was re-established (see the *Guide*, recommendation 47); and the priority derived from such a reinstated registration dates from the time of reinstatement (see the *Guide*, recommendation 96). As a result, if there is a time difference between the lapse and the reinstatement of registration, the original priority is lost but only as against competing claimants whose right arose during the period after the lapse and before the reinstatement of the registration.

G. Effective time of registration

53. Where the registration information is electronically transmitted, the registry system typically is programmed to assign a time of registration only when the registration information has successfully been entered into the registry record. This means that the effective time of registration is concurrent with the time at which the registration becomes searchable by third parties.

54. In systems that offer the option of submitting registrations in paper form, approaches vary. In some States, the time of registration is assigned as soon as the paper statement is physically received in the offices of the registry. However, the resulting time lag between the effective time of registration and the time as of which the registration becomes available to a searcher creates a priority risk for third parties that may find themselves bound by a registration that has not yet appeared on the public record. To deal with this problem, search results can be programmed to indicate a “file currency time” that is earlier than the real time of the search. The file currency time means that the search result is only designed to disclose the state of registrations up to that time. It follows that interested third parties, after conducting a first search and making a registration to ensure their priority position, will have to conduct a second search before being confident in advancing funds or otherwise acting in reliance on the registry record. The better practice is to assign the time of registration only upon entry of the registration information into the registry system so as to make registration and the ability to search temporally coincident (see the *Guide*, recommendation 70). Quick entry of the registration information is made easier through technological advances. As a result, instances where delays occur because an excessive amount of information has to be entered into the record are becoming increasingly rare. Where such delays occur, access to credit may be unduly delayed by obsolete technology or by the fact that electronic registration is not available.

H. Mandatory cancellation and amendment of registration

55. A registration may not reflect, or may no longer reflect, an existing security relationship between the parties named in the registration. This may happen because, after the registration, a contemplated secured loan may not have materialized or because the secured lending relationship represented by the registration may have come to an end. In such a case, the continued presence of the registration on the records of the registry will limit the ability of the person named as grantor to sell or create a new security right in the assets described in the registration.

56. Ordinarily, a secured creditor will be willing to register a cancellation of the registration on the request of the person named as grantor. However, if the secured creditor refuses, a summary judicial or administrative procedure should be established to compel cancellation of the registration (see the *Guide*, recommendation 72). The procedure should be quick and simple, in particular if it requires an action by the registrar as the registrar is not an adjudicatory body that is designed to weigh evidence and consider competing legal arguments.

57. Similar issues arise when a registration contains inaccurate information that may be prejudicial to the ability of the person named as grantor to deal with its assets in favour of other secured creditors or buyers; for example, the description of the encumbered assets in the registration may include items that are not in fact covered by an underlying security agreement. Accordingly, the procedure should be crafted in a way that also allows the named grantor to bring about an amendment of the information in the registration to reflect the actual status of the relationship between the parties.

58. To address these issues, some modern registration regimes permit the grantor, and any person with a right in the assets described in a registration to send a written notice to the secured creditor named in the notice to cancel or amend the registration if: (a) all the obligations under the security agreement to which the registration relates have been performed; (b) the secured creditor has agreed to release all or part of the assets described in the registration from the security right; (c) the description of the encumbered assets in the registration includes assets that are not encumbered under a security agreement between the parties; or (d) no security agreement exists between the parties. If the secured creditor does not comply with the request within a certain number of days, the person making the demand may request a court or the registrar to register the cancellation or amendment on proof that the request was made and not met after notice to the secured creditor. The registration may be cancelled or amended as requested unless within a certain number of days of being notified of the request to the court or the registrar, the secured creditor obtains a court order maintaining it (see the *Guide*, recommendation 72). Caution should be exercised to avoid requiring the registrar to weigh evidence and consider arguments as if it was an adjudicatory body.

59. A secured creditor should always be in a position to amend or cancel a registration at any time (see the *Guide*, recommendation 73). Once a registration has been cancelled, it should be removed from the record available to searchers. However, in modern registry systems, the registration information is preserved in an archive record that is not open to searchers for future reference, if necessary. Retrieval of the information may be necessary, for example, to establish the priority of a security right at a particular point of time in the past (see the *Guide*, recommendation 74).

I. Entitlement to search

60. To achieve its publicity objectives, a modern security rights registry must be publicly accessible by third-party searchers (see the *Guide*, recommendation 54, subpara. (f)). A searcher does not need to justify the reasons for the search (see the *Guide*, recommendation 54, subpara. (g)). Registrations are normally indexed and

can be retrieved by searchers according to the identifier of the grantor (see the *Guide*, recommendation 54, subpara. (h)). These rules apply to all types of search, irrespective of the search criterion (grantor identifier, asset description or serial number, or registration number).

61. A search report should normally disclose the information available in the public record of the registry (identifier of the grantor and the secured creditor or its representative, description of the encumbered asset, and if required the maximum amount of the secured obligation; see the *Guide*, recommendations 54, subpara. (a) and 57). The fees for registration and searching, if any, should be no higher than the fees necessary to recover the cost of the development and operation of the registry (see the *Guide*, recommendation 54, subpara. (i)). To the extent possible, the registration and searching process should be electronic (see the *Guide*, recommendation 54, subpara. (j)). Finally, the registry should be designed so as to be accessible continuously except for brief periods to undertake routine scheduled maintenance (see the *Guide*, recommendation 54, subpara. (l)).

62. In the name of privacy, some States restrict access to searchers with a demonstrated existing interest in the grantor's affairs. In those States, the searcher has to demonstrate that it has a justifiable reason for searching, and the registrar has to make a decision. This is the result of a misunderstanding of the purpose of establishing the registry which is to enable third parties that are contemplating to acquire a right in a particular asset (by way, for example of sale, security or judgment enforcement proceedings) to determine the extent to which the grantor's assets may already be encumbered. In addition, requiring searchers to demonstrate an interest in the grantor's commercial affairs would require the establishment of an administrative process and the intervention of registry staff. This approach would be inconsistent with the efficient and transparent operation of a modern registry system. In some States, a searcher has to have an authorized purpose only for a search relating to an individual grantor. The reason for this approach is the need to protect the privacy of individual grantors. In those States, however, prospective buyers or lenders are authorised to search against an individual grantor's details.

J. Search criteria

63. The grantor's identifier and, in systems that recognize supplementary serial number asset registration, the serial number or other numerical asset identifier are the commonly recognized search criteria and the applicable legal rules and search forms will need to set this out explicitly. Since the registration and search criteria are mirror images, it should be made clear that the rules applicable to grantor and asset identifiers for the purposes of registration also apply to the search process.

64. Where a registry permits registration of both the identifier of the grantor (whether a name or a number) and the serial number of the encumbered asset, both should be registered. This would facilitate searching as a search against either of these two search criteria would capture the registration.

65. The registration number assigned by the registry to a registration and given to the secured creditor and the grantor (a registry system may be designed to do that automatically) also constitutes a commonly available search criterion. The aim is to give a registrant or searcher an alternative means to retrieve a registration. It should

be noted that some registry systems are designed to allow searches only by initial registration numbers, while other registry systems are designed to allow searches by registration numbers assigned to amendments.

66. Many registries also create an index of the names of secured creditors. What actually happens is that the registry software is designed so as to provide a query tool that permits a registrar to find information according to a number of different criteria, including the secured creditor's name. This enables registry staff, on behalf of a secured creditor, to efficiently register a global amendment when the secured creditor changes its name or address. Many service companies also provide these "global amendment" services to their clients. A question that would need to be addressed is whether registry staff should be exercising discretion in the form of identifying information to which a global amendment is to be made.

67. In any case, the name or other identifier of the secured creditor is not generally recognized as a search criterion for searching by the public. The identity of the secured creditor has limited relevance to the legal objectives of the registry system (see the *Guide*, recommendation 64). To allow public searching might violate the reasonable privacy expectations of secured creditors, for example, because of the risk that a credit provider might use a search of the registry record to obtain the client lists of its competitors (see the *Guide*, chap. IV, para. 81).

K. Language of registration and searching

68. Modern registry rules also address the language requirements for entering information in a registration. Typically, this will be the official language of the State under whose authority the registry is maintained. Where a State recognizes more than one official language, registrants typically may effect registrations using any one of them. Search results will display information in a registration in the language used to create the registration (see the *Guide*, chap. IV, paras. 44-46).

V. Registry design, administration and operation

A. Introduction

69. Technical design, administrative and operational issues are crucial components of an effective and efficient registry system. Some of the issues that might usefully be addressed in the text on registration are canvassed in this chapter.

B. Electronic versus paper-based registry records

70. Registry records traditionally were maintained in paper form or were subsequently scanned into electronic form. In some States, this is still the case. The transaction and administrative costs associated with this method of storage are very high. In contrast, registration information in all modern secured transactions registries are entered and stored in electronic form in a centralized computer database (see the *Guide*, chap. IV, paras. 38-43).

71. An electronic registry database offers enormous efficiency advantages over a traditional paper-based record, including:

- (a) A greatly reduced archival and administrative burden (the burden of ensuring the accuracy of the registration information is placed on the secured creditor);
- (b) A reduced vulnerability to physical damage, theft and sabotage;
- (c) The ability to consolidate all registrations in a single record regardless of the geographical entry point of the registration data; and
- (d) The facilitation of speedy low-cost registration and search processes.

C. Centralized and consolidated registry record

72. In modern registry systems, while registrants may choose among multiple modes and points of access to the registry (see the *Guide*, recommendation 54, subpara. (k)), the record is maintained in electronic form in a single centralized database (see the *Guide*, recommendation 54, subpara. (e)). This approach ensures the efficiency, accessibility and transparency of the registry. Equality of access for users in remote locations is achieved through the rapid onward transmission of registered information that is made possible by modern means of communication. In addition, modern means of communication make it possible to establish mechanisms for online access to the centralized and consolidated registry record (see the *Guide*, chap. IV, paras. 21-24).

D. User access to the registry record

73. A computerized registry database enables the system to be designed so that users can enter registration information and conduct searches directly without the need for the assistance or intervention of registry personnel. Accordingly, most modern systems authorize the electronic submission of registration information, and the electronic submission and retrieval of search requests over the internet or via specialized communications systems (see the *Guide*, chap. IV, paras. 25 and 26).

74. Compared with a system in which registration information and search inquiries must be entered by registry staff on behalf of users, a user-administered electronic access system offers the following advantages:

- (a) A very significant reduction in the staffing and other day-to-day costs of operating the registry;
- (b) Reduced risk of error and reduced opportunity for fraudulent or corrupt conduct on the part of registry personnel;
- (c) A corresponding reduction in the potential liability of the registry to users who otherwise might suffer loss as a result of the failure of registry staff to enter registration and search data or to enter it accurately;
- (d) User access 24 hours a day and 7 days a week.

75. In light of these advantages, a modern registry system should be designed to permit direct electronic user access for both registration and searching. Under this approach, frequent users (such as financial institutions, automobile dealers, lawyers acting for creditor clients) would be able to access the registry database from their own computer facilities after entering into an account agreement with the registry. Access for infrequent users typically would be made available through public computer terminals located at government service outlets throughout the jurisdiction. In addition, owing to the radically reduced costs associated with direct electronic access, third-party private sector service providers will often be able to perform registration and search services on behalf of users at a minimal surcharge.

76. To preserve the security and integrity of the registry database, all users would be issued unique access codes and passwords. In order to enter registrations, users would either have to have an existing account agreement with the registry or provide identification documents if they are using the public “walk-in” computer terminals. This system virtually eliminates the risk of fraudulent or unauthorized terminations or amendments. It would also permit automatic charging of fees to the users’ registry account and institutional control of the user’s access rights.

E. Specific design and operational considerations

1. Establishment of an implementation team

77. It is critical that the technical professionals responsible for building the registry system are fully apprised of the legal goals that it is designed to fulfil and of the practical needs of the registry personnel who will be entrusted with its administration and of potential registry users. Consequently, it is necessary at the very outset of the design process to establish an implementation team that reflects technological, legal, administrative and user perspectives and expertise.

2. Design and operational responsibility

78. It will be necessary at an early stage to determine whether the registry is to be designed and operated in-house by a governmental agency or in partnership with a private sector firm with demonstrated technical experience and financial accountability. Even if the partnership option is chosen, States should retain ultimate supervisory and legal responsibility and ownership of registry hardware and software.

3. System capacity

79. The implementation team will need to plan the database capacity of the registry. This assessment will depend in part on whether the registry is intended to cover consumer as well as business secured financing transactions in which event, a much greater volume of registrations can be anticipated. Capacity planning will need to take into account not only the projected database space utilization, but also the potential for additional applications and features to be added to the system (for example, the expansion of the registry database at a later point to accommodate the registration of judgments or non-consensual security rights or the addition of linkages to other governmental databases such as the state’s corporate registry or other movable or immovable registries).

4. Programming

80. The programming specifications for the registry will depend on the applicable registration and search criteria and in particular whether grantor-based registration, indexing and searching will be supplemented by serial number registration, indexing and searching. The hardware and software specifications should be robust and secure employing security features that minimize the risk of data corruption, technical error and hacking. In addition to database programmes, software will also need to be developed to manage user communications, user accounts, payment of fees and financial accounting, electronic links between registries, computer-to-computer communication and the gathering of statistical data on registrations and searches.

81. In some States where grantors or assets are often identified by a number, the registry is designed so as to enable it to verify the number with an external registry. For example, a serial number entered can be verified with a relevant external database, where this is possible (for example, with the motor vehicle registry or the company registry). This assists in ensuring that the correct serial number has been entered.

5. Data quality

82. A notice-based secured transactions registry is not intended to guarantee or evidence the existence or effectiveness of the security rights to which registrations relate. However, the system can be designed to ensure a basic level of information quality, while also protecting registrants from their own inadvertent errors by, for example, incorporating mandatory fields, edit checks, drop-down menus and online help resources.

6. Back-up servers

83. While an electronic registry database is inherently less vulnerable to physical damage and sabotage than a paper record, back-up servers should be established so as to ensure uninterrupted access and service in the event the primary servers fail.

7. Role of registry staff and liability

84. The role of registry staff should essentially be limited to managing and facilitating access by users, processing fees and overseeing the operation and maintenance of the system. If registrants are responsible for verifying the accuracy and entering registration information themselves, they bear sole responsibility for any errors or omissions in the registration information and carry the burden of entering the necessary corrections or amendments.

85. The potential liability of the registry is therefore restricted to: (a) liability for incorrect or misleading verbal advice or information; and (b) liability for loss resulting from erroneous or incomplete search results caused by a system failure. Registry staff should also have responsibility for ongoing monitoring of the way the registry is working (or not working) in practice, including gathering statistical data on the quantity and types of registrations and searches that are being made, in order to be in a position to quickly make any necessary adjustments to the applicable laws or registration and search processes (see the *Guide*, recommendation 56). Each State

will need to enact rules stipulating the extent of its responsibility, if any, for these risks.

8. Financing initial development and operational costs (registration and search fees)

86. The implementation of a modern electronic registry requires an initial capital investment to cover the development of the registry, the hardware and the software costs. However, the low cost of operation of an electronic registry means that this investment should be recoverable out of service fees within a relatively short period after the establishment of the registry. Registration and search fees should be set at a cost-recovery level as opposed to being used to extract tax revenue. Otherwise the added transaction costs will undermine the overall success of reform (see the *Guide*, recommendation 54, subpara. (i)).

87. If it is decided to develop and operate the registry in partnership with a software and service provider, it may be possible for the partner to make the initial capital investment in the registry infrastructure on the understanding that it will be entitled to recoup its investment through a transaction fee once the registry is up and running.

9. Education and training

88. To ensure a smooth implementation of the registry system and its active take up by potential users, the implementation team will need to develop education and awareness programmes, disseminate promotional and explanatory literature, and conduct training sessions.

VI. Additional issues

A. Supervision and operation of the registry

89. An overview of current approaches to the question of which government institution would be better prepared to establish and supervise the operation of the registry and the ways in which the registry could be operated could provide useful guidance to States. Under the *Guide*, while the day-to-day operation of the registry may be delegated to a private entity, States would retain the responsibility for ensuring that the registry would be operated in accordance with the established legal framework (see the *Guide*, chap. IV, para. 47 and recommendation 55, subpara. (a)).

B. Registration of acquisition security rights

90. Acquisition security rights have special priority status. One issue that might be discussed is whether the registration should indicate that it relates to an acquisition security right.

C. Anti-corruption measures

91. The registry design must make corruption as difficult as possible. Various measure may be considered including: (a) making it impossible for registry staff to

alter time and date of registration, as well as other information entered by a registrant; (b) not permitting registry officials to exercise discretion over whether a registration is accepted or rejected; and (c) removing any contact of registry staff with cash fee payments.

D. Transition

92. Transition and migration of existing data (security rights) when creating a new registry will also need to be discussed. This is a critical point and States will need to have guidance on what to do when modernizing their existing registries.

E. Dispute resolution

93. A dispute resolution mechanism may be considered to settle controversies between the parties involved in registrations relating to security rights. The mechanism should include summary judicial or administrative procedures discussed with regard to the cancellation or amendment of registration (see paras. 55-59 above). It may also include fast and amicable procedures, such as online mediation and arbitration.
