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Draft Technical Legislative Guide on the Implementation of a Security Rights Registry

Note by the Secretariat

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Preface

At its forty-second session (Vienna, 29 June-17 July 2009), the Commission noted with interest the future work topics discussed by Working Group VI at its fourteenth and fifteenth sessions (A/CN.9/667, para. 141, and A/CN.9/670, paras. 123-126). At that session, the Commission agreed that the Secretariat could hold an international colloquium early in 2010 to obtain the views and advice of experts with regard to possible future work in the area of security interests.¹ In accordance with that decision,² the Secretariat organized an international colloquium on secured transactions (Vienna, 1-3 March 2010). At the colloquium several topics were discussed, including registration of security rights in movable assets, security rights in non-intermediated securities, a model law on secured transactions, a contractual guide on secured transactions, intellectual property licensing and implementation of UNCITRAL texts on secured transactions. The colloquium was attended by experts from governments, international organizations and the private sector.³

At its forty-third session (New York, 21 June-9 July 2010), the Commission considered a note by the Secretariat on possible future work in the area of security interests (A/CN.9/702 and Add.1). The note discussed all the items discussed at the colloquium. The Commission agreed that all issues were interesting and should be retained on its future work agenda for consideration at a future session on the basis of notes to be prepared by the Secretariat within the limits of existing resources. However, in view of the limited resources available to it, the Commission agreed that priority should be given to registration of security rights in movable assets.⁴

In that connection, it was widely felt that a text on registration of security rights in movable assets would usefully supplement the Commission's work on secured transactions and provide urgently needed guidance to States with respect to the establishment and operation of security rights registries. It was stated that secured transactions law reform could not be effectively implemented without the establishment of an efficient publicly accessible security rights registry. It was also emphasized that the *UNCITRAL Legislative Guide on Secured Transactions* (the "*Secured Transactions Guide*") did not address in sufficient detail the various legal, administrative, infrastructural and operational questions that needed to be resolved to ensure the successful implementation of a registry.⁵

The Commission also agreed that, while the specific form and structure of the text could be left to the Working Group, the text could: (a) include principles, guidelines, commentary, recommendations and model regulations; and (b) draw on the *Secured Transactions Guide*, texts prepared by other organizations and national law regimes that have introduced security rights registries similar to the registry recommended in the *Secured Transactions Guide*. After discussion, the Commission

¹ *Official Records of the General Assembly, Sixty-fourth Session, Supplement No. 17 (A/64/17)*, paras. 313-320.

² *Ibid.*

³ For the colloquium papers, see www.uncitral.org/uncitral/en/commission/colloquia/3rdint.html.

⁴ *Ibid.*, *Sixty-fifth Session, Supplement No. 17 (A/65/17)*, paras. 264 and 273.

⁵ *Ibid.*, para. 265.

decided that the Working Group should be entrusted with the preparation of a text on registration of security rights in movable assets.⁶

At its eighteenth session (Vienna, 5-10 November 2010), the Working Group considered a note by the Secretariat entitled “Registration of security rights in movable assets” (A/CN.9/WG.VI/WP.44 and Add.1 and 2). At the outset, the Working Group expressed its broad support for a text on the registration of security rights in movable assets, noting that empirical evidence clearly demonstrated that the efficacy of a secured transactions law depended on an effective registration system (A/CN.9/714, para. 12). As to the specific form and structure of the text to be prepared, the Working Group adopted the working assumption that the text would be a guide on the implementation and operation of a registry of security rights in movable assets that could include principles, guidelines, commentary and possibly model regulations. The Working Group also agreed that the text of the proposed registry guide should be consistent with the type of secured transactions legal regime contemplated by the *Secured Transactions Guide*, while also taking into account the diverse approaches taken by modern national and international registry regimes. It was also observed that, in line with the *Secured Transactions Guide* (see recommendation 54, subpara. (j)), the proposed registry guide should take into account the need to accommodate a hybrid electronic/paper system in which parties would have the option of submitting registration and search inquiries either electronically or in paper form (A/CN.9/714, para. 13). The Secretariat was asked to prepare a draft of the proposed registry guide based on the discussions and conclusions of the Working Group (A/CN.9/714, para. 11).

At its nineteenth session (New York, 11-15 April 2011), the Working Group considered notes by the Secretariat entitled “Draft Security Rights Registry Guide” (A/CN.9/WG.VI/WP.46 and Add.1 and 2) and “Draft Model Regulations” (A/CN.9/WG.VI/WP.46/Add.3). At the outset, the Working Group considered the form and content of the text to be prepared. One view was that a stand-alone guide should be prepared that would include an educational part introducing the secured transactions law recommended in the *Secured Transactions Guide* and a practical part that would consist of model registration regulations and commentary thereon (see A/CN.9/719, para. 13). Another view was that emphasis should be placed on model registration regulations and a commentary thereon, which would provide States that had enacted the secured transactions law recommended in the *Secured Transactions Guide* with practical advice as to the issues to be addressed in the context of the establishment and operation of a general security rights registry (see A/CN.9/719, para. 14). At that session, differing views were also expressed as to whether the regulations should be formulated as model regulations or as recommendations (A/CN.9/719, para. 46). The Working Group requested the Secretariat to prepare a revised version reflecting the deliberations and decisions of the Working Group (A/CN.9/714, para. 12).

At its forty-fourth session (Vienna, 27 June-8 July 2011), the Commission considered the reports of the eighteenth and nineteenth sessions of the Working Group (A/CN.9/714 and A/CN.9/719, respectively). At that session, the significance of the work undertaken by Working Group VI was emphasized in particular in view of efforts currently undertaken by several States with a view to establishing a

⁶ Ibid., paras. 266-267.

general security rights registry and the significant beneficial impact the operation of such a registry had on the availability and the cost of credit. With respect to the form and content of the text to be prepared, it was stated that, following the approach followed with respect to the *Secured Transactions Guide*, the text should be formulated in the form of a guide with commentary and recommendations, rather than as a text with model regulations and commentary thereon. In that connection, it was noted that the next version of the text before the Working Group would be formulated in a way that would leave the matter open until the Working Group had made a decision. After discussion, the Commission agreed that the mandate of the Working Group, leaving the decision on the form and content of the text to be prepared to the Working Group, did not need to be modified, and that, in any case, a final decision would be made by the Commission once the Working Group had completed its work and submitted the text to the Commission.⁷

At its twentieth session (Vienna, 12-16 December 2011), the Working Group continued its work based on a note by the Secretariat entitled “Draft Security Rights Registry Guide” (A/CN.9/WG.VI/WP.48 and Add.1-3). At that session, the Working Group agreed that the text should take the form of a guide (the “draft Registry Guide”) with commentary and recommendations along the lines of the *Secured Transactions Guide*. In addition, the Working Group agreed that, where the draft Registry Guide offered options, examples of model regulations could be included in an annex to the draft Registry Guide (A/CN.9/740, para. 18). As to the presentation of the text, it was agreed that the draft Registry Guide should be presented as a separate, stand-alone, comprehensive text that would be consistent with the *Secured Transactions Guide*, and be tentatively entitled “Technical Legislative Guide on the Implementation of a Security Rights Registry” (A/CN.9/740, para. 30).

At its twenty-first session (New York, 14-18 May 2012), the Working Group considered a note by the Secretariat entitled “Draft Technical Legislative Guide on the Implementation of a Security Rights Registry: Annex I. Terminology and recommendations” (A/CN.9/WG.VI/WP.50 and Add.1-2). At that session, the Working Group approved the substance of the terminology and the recommendations of the draft Registry Guide (A/CN.9/743, para. 21). In addition, the Working Group agreed that the draft Registry Guide should be finalized and submitted to the Commission for adoption at its forty-sixth session, in 2013 (A/CN.9/743, para. 73).

At its forty-fifth session (New York, 25 June-6 July 2012), the Commission considered the reports of the twentieth and twenty-first sessions of the Working Group (A/CN.9/740 and A/CN.9/743, respectively). At that session, the Commission expressed its appreciation to the Working Group and requested the Working Group to proceed with its work expeditiously and to complete it so that the draft Registry Guide would be submitted to the Commission for final approval and adoption at its forty-sixth session, in 2013.⁸

At its twenty second session, the Working Group considered a note by the Secretariat entitled “Draft Technical Legislative Guide on the Implementation of a Security Rights Registry” (A/CN.9/WG.VI/WP.52 and Add.1-6). At that session, the Working Group adopted the substance of the draft Registry Guide and requested the

⁷ Ibid., *Sixty-sixth Session, Supplement No. 17* (A/66/17), para. 233.

⁸ Ibid., *Sixty-seventh Session, Supplement No. 17* (A/67/17), para. 99.

Secretariat to prepare a revised version of the text reflecting the deliberations and decisions of the Working Group (A/CN.9/764, para. 15).

[*Note to the Working Group: The Working Group may wish to note that the preface will be updated after each Working Group meeting and completed after the Commission adopts the draft Registry Guide at its forty-sixth session, in 2013.*]

Introduction

A. Purpose of the draft Registry Guide and its relationship with the *Secured Transactions Guide*

1. The *UNCITRAL Legislative Guide on Secured Transactions* (the “*Secured Transactions Guide*”) deals with the full range of issues that should be addressed in a modern secured transactions law (as supplemented with respect to security rights in intellectual property by the *Supplement on Security Rights in Intellectual Property*; the “*Supplement*”). The establishment of a publicly accessible registry in which information about the potential existence of a security right in movable assets may be registered is an essential feature of the *Secured Transactions Guide* and of modern law reform initiatives in this area generally. Chapter IV of the *Secured Transactions Guide* contains commentary and recommendations on many aspects of a general security rights registry. Chapters III and V address the related issues of third-party effectiveness and priority of a security right.

2. However, the *Secured Transactions Guide* does not address in every detail the myriad of legal, technological, administrative and operational issues involved in developing and operating an effective and efficient general security rights registry. This is in line with the typical legislative drafting approach. Thus, the detailed rules applicable to the establishment and the operation of the registry, as well as the registration and search process, are dealt with in subordinate regulations, ministerial guidelines or the like. The draft Technical Legislative Guide on the Implementation of a Security Rights Registry (the “draft Registry Guide”) seeks to implement the *Secured Transactions Guide* by addressing these issues in greater detail.

3. It should be emphasized at the outset that the recommendations of the draft Registry Guide are intended to be implemented by States that have enacted or are prepared to enact a secured transactions law that is substantially in conformity with the recommendations of the *Secured Transactions Guide*. For example, in order to implement the recommendations of the draft Registry Guide, a State would need to have in place or be prepared to enact a secured transactions law that provides for notice (rather than document) registration and that treats registration as a method of making a security right effective against third parties (rather than for creating a security right). It follows that, in order to understand the legal framework in which the registry is intended to function, a user of the draft Registry Guide should have a basic understanding of the secured transactions law contemplated by the *Secured Transactions Guide*. Section E of the Introduction to the draft Registry Guide offers a summary of the secured transactions regime recommended by the *Secured Transactions Guide* and other chapters include additional guidance. For a thorough understanding, however, the draft Registry Guide should be read together with the *Secured Transactions Guide*.

4. The experience of States that have instituted the kind of general security rights registry contemplated by the *Secured Transactions Guide* demonstrates how advances in information technology can significantly improve its operational efficiency. Particularly in relation to the technical aspects of registry design and operation, the draft Registry Guide draws on these national precedents. In addition, the draft Registry Guide has benefitted from international sources that deal with secured transactions, including the following:

(a) Law and Policy Reform at the Asian Development Bank — A Guide to Movables Registries, Asian Development Bank (ADB) (2002);

(b) Publicity of Security Rights: Guiding Principles for the Development of a Charges Registry, European Bank for Reconstruction and Development (EBRD) (2004);

(c) Publicity of Security Rights: Setting Standards for Charges Registries, EBRD (2005);

(d) Model Registry Regulations under the Model Inter-American Law on Secured Transactions, Organization of American States (OAS) (2009);

(e) Principles, Definitions and Model Rules of a European Private Law, Draft Common Frame of Reference (DCFR), volume 6, book IX (Proprietary security in movable assets), chapter 3 (Effectiveness as Against Third Parties), section 3 (Registration), (2010), Study Group on a European Civil Code and the Research Group on EC Private Law (Acquis Group) (2010);

(f) Secured Transactions Systems and Collateral Registries, The International Finance Corporation (World Bank Group) (2010); and

(g) Convention on International Interests in Mobile Equipment (Cape Town, 2001) and Regulations and Procedures for the International Registry, document 9864, International Civil Aviation Organization (ICAO) (4th ed. 2010).

5. The national, regional and international sources referred to above are largely consistent with, but do not always fully accord with, the recommendations of the *Secured Transactions Guide*. Where appropriate, the draft Registry Guide explains the policy rationale for the approach recommended in the *Secured Transactions Guide* relative to other possible approaches.

6. The draft Registry Guide is addressed to all those who are interested or actively involved in the design and implementation of a security rights registry, as well as to those who may be affected by or interested in its establishment and operation, including:

(a) Policymakers implementing the recommendations of the *Secured Transactions Guide*, especially in relation to the establishment of a security rights registry;

(b) Registry system designers, including technical staff charged with the preparation of design specifications and with fulfilling the hardware and software requirements for the registry;

(c) Registry administrators and staff;

(d) Registry clientele, including potential secured creditors, credit reporting agencies, other creditors of the grantor of a security right and the grantor's insolvency representative, as well as all other persons whose rights may be affected by a security right, such as a potential buyer of an encumbered asset;

(e) The general legal community (including judges, arbitrators and practising lawyers); and

(f) All those involved in secured transactions law reform and the provision of technical assistance, such as the World Bank Group, the EBRD, the ADB and the Inter-American Development Bank.

7. The draft Registry Guide uses neutral generic legal terminology that is consistent with the terminology used in the *Secured Transactions Guide*. Consequently, it can be adapted readily to the diverse legal traditions and drafting styles of different States. The draft Registry Guide is also formulated in a flexible fashion enabling it to be implemented in accordance with local drafting conventions regarding which types of rule must be incorporated in principal legislation and which may be left to subordinate regulations, or ministerial or other administrative rules.

B. Terminology and interpretation

8. The terminology and interpretation section of the *Secured Transactions Guide* (see Introduction, sect. B, para. 20), applies also to the draft Registry Guide, except to the extent modified below. The terminology of the draft Registry Guide is also consistent with the refinement of these terms and the explanations of additional terms in the various chapters of the *Secured Transactions Guide*. For example, when the draft Registry Guide uses the term “future asset”, it means assets that come into existence or are acquired by the grantor after the time the security agreement is entered into (see *Secured Transactions Guide*, chap. I, para. 8; chap. II, para. 51; and chap. V, para. 151).

9. However, the draft Registry Guide modifies certain terminological and interpretation provisions of the *Secured Transactions Guide* for purposes of their use in the draft Registry Guide and also introduces additional terms as follows:

(a) Address

“Address” means: (i) a physical address, including a street address and number, city, postal code and State; (ii) a post office box number, city, postal code and State; (iii) an electronic address; or (iv) another address that would be effective for communicating information.

(b) Amendment

“Amendment” means the modification of information contained in a previously registered notice to which the amendment relates.

10. Registration of an amendment notice does not result in the deletion from the registry record of previously registered notices to which the amendment notice relates. It may have the effect, however, of modifying or terminating the effectiveness of a previously registered notice with respect to a particular security

right (see A/CN.9/WG.VI/WP.54/Add.2, para. 46, and A/CN.9/WG.VI/WP.54/Add.4, paras. 1-22).

(c) Cancellation

“Cancellation” means the removal of [all] information contained in a previously registered notice to which the cancellation relates from the public registry record.

11. The legal consequence of the registration of a cancellation notice is that the previously registered notice to which it relates is no longer effective (see A/CN.9/WG.VI/WP.54/Add.4, paras. 23-25).

(d) Designated field

“Designated field” means the space on the prescribed form of notice designated for entering the specified type of information.

(e) Grantor

“Grantor” means the person identified in the notice as the grantor.

(f) Law

“Law” means the law of the enacting State governing security rights in movable assets.

12. The secured transactions law of the enacting State has to be in substantial conformity with the recommendations of the *Secured Transactions Guide* (see para. 3 above).

(g) Notice

“Notice” means a communication in writing (paper or electronic) to the registry of information with respect to a security right; a notice may be an initial notice, an amendment notice or a cancellation notice.

13. In the registration context, the *Secured Transactions Guide* uses the term “notice” to refer both to the form that a registrant uses to submit information to the registry (see *Secured Transactions Guide*, Introduction, sect. B, “notice”, and recs. 54, subpara. (b), and 57), and to the “information contained in a notice” or “the content of the notice” (see *Secured Transactions Guide*, recs. 54, subpara. (d), and 57). The draft Registry Guide uses the term “notice” in the same way.

(h) Registrant

“Registrant” means the person who completes a registry notice form and submits it to the registry [and may be a service provider].

14. The registrant may be the secured creditor (including an agent or trustee in the case of a syndicate of lenders) or its representative (e.g., a law firm or other service provider that is identified in the notice as the secured creditor). A courier or other mail service provider used by the registrant to transmit the notice is not the registrant and its identity is irrelevant.

(i) Registrar

“Registrar” means the person appointed pursuant to the law and the regulation to supervise and administer the operation of the registry.

(j) Registration

“Registration” means the entry of information contained in a notice into the registry [record] [database].

(k) Registration number

“Registration number” means a unique number allocated to an initial notice by the registry and permanently associated with that notice and any related notice.

(l) Registry record

“Registry record” means the information in all registered notices that is stored in the registry [record] [database] and consists of the record that is publicly accessible (public registry record) and the record that has been removed from the public registry record (registry archives).

15. Because the term “registry record” means the information contained in all registered notices (and not just the notices relating to a specified grantor), when referring to a particular notice in the registry record, reference is made to a “registered notice” as opposed to the “registry record”.

(m) Regulation

“Regulation” means the body of rules implemented by the enacting State with respect to the registry, whether these rules are found in administrative guidelines or the substantive secured transactions law.

16. The exact form and contents of the regulation will depend on the legislative policy and drafting technique of each enacting State. For example, if the secured transactions law is enacted in two or more statutes (e.g., one that deals with all the substantive rules, another that deals with conflict-of-laws rules, and another that establishes the registry), there may be rules relating to registration that are enacted as subordinate legislation (e.g., a regulation that is a separate enactment) in respect of all these statutes.

(n) Secured creditor

“Secured creditor” means the person identified in the notice as the secured creditor [and may be the secured creditor or its representative].

[Note to the Working Group: The Working Group may wish to note that: (a) the terms “amendment” and “cancellation” are explained by reference to their generic meaning, rather than their legal effect which is addressed in the commentary; (b) the bracketed text in the term “cancellation” may be necessary to distinguish a cancellation from an amendment; (c) the term “notice” is explained by reference to both the medium and the information contained therein; (d) the term “registrant” is explained by reference to the meaning of that term as is generally understood (the language in square brackets may be retained in the terminology or in the commentary); (e) the term “registry record” is used to reflect the contents (information) by reference to the container (the database); (f) the term “secured creditor” is a new term intended to clarify that the registry may rely on the person who is identified in the notice as the secured creditor or the secured creditor of record (the language in square brackets may be retained in the terminology or in the commentary). As the difference between the term “registry record” (the contents) and the term “database” (the container) may not be clear to the average reader of

the draft Registry Guide, the Working Group may wish to consider whether: (a) the difference between the two terms should be explained in the commentary; or (b) in view of the fact that the recommendations of the Secured Transactions Guide use only the term “registry record” and most of recommendations of the draft Registry Guide use the term “registry record” (see, for example, recs. 3, subpara. (e) and 16), the reference to the term “database” in the terminology (subparas. (j) and (l)) and in recommendations 3, subparagraphs (d) and (g) and recommendation 11 should be replaced with a reference to the term “registry record” (in the sense of both the contents and the container). The Working Group may also wish to consider whether the term “registry” should also be explained along the following lines: “‘Registry’ means a system established for registering information about security rights in movable assets”.]

C. Key objectives and fundamental policies of an efficient registry

17. The security rights registry envisaged by the *Secured Transactions Guide* and the draft Registry Guide is informed by the following overarching principles:

(a) The legal and operational guidelines governing registry services, including registration and searching, should be simple, clear and certain from the perspective of all potential users; and

(b) Registry services, including registration and searching, should be designed so as to be as fast and inexpensive as possible, while also ensuring the security and searchability of the information entered in the registry record.

D. Overview of secured transactions law and the role of registration

1. General

18. As already mentioned, a general security rights registry is an integral component of the secured transactions regime recommended by the *Secured Transactions Guide*. The potential users of the draft Registry Guide will not necessarily be versed in the intricacies of that regime or even have legal training. Accordingly, this section provides an overview, focusing in particular on the legal function and consequences of registration. For more detailed guidance, the reader is encouraged to then refer to the *Secured Transactions Guide*.

2. Concept of a security right

19. In general terms, a security right is a property right (a right in rem, distinct from ownership and personal rights) in a movable asset that is created by agreement and secures payment or other performance of an obligation (see the term “security right” and “grantor” in the introduction to the *Secured Transactions Guide*, sect. B). The function of a security right is to mitigate the risk of loss resulting from a default in payment by entitling the secured creditor to claim the value of the assets encumbered by the security right as a back-up source of repayment in preference to the claims of the grantor’s other creditors. For example, if a business that borrows funds on the security of its equipment fails to repay the loan, a secured creditor with a security right in that equipment will be entitled to obtain possession and dispose

of the equipment and apply the proceeds to the outstanding balance. As the risk of loss from default is mitigated, the grantor's access to credit is expanded, quite often on more favourable terms.

20. The *Secured Transactions Guide* adopts a functional approach to the concept of a security right. Under this approach, the term encompasses any type of property right in a movable asset that functions in substance to secure performance of an obligation (see *Secured Transactions Guide*, chap. I, paras. 101-112, and recs. 2 and 10). Thus, the concept is not limited to the types of nominated security device conventionally recognized by different legal systems, such as a pledge, charge or hypothec. It encompasses any type of property right that functions as security. As such, it includes a transfer of tangible assets or assignment of intangible assets for security purposes, as well as a retention-of-title by a seller to secure payment of the purchase price of an asset or the residual ownership of a lessor under a financial lease (see *Secured Transactions Guide*, chap. I, paras. 101-112 and recs. 2, 8 and 9).

21. The *Secured Transactions Guide* recommends this functional, integrated and comprehensive approach to the concept of security in order to ensure that the legal rights of creditors, debtors and third parties are subject to a common legal framework regardless of the form of the transaction, the type of encumbered asset, the nature of the secured obligation or the status of the parties. However, it recognizes that secured transactions covering specified types of encumbered asset may need to be excluded either because they are already covered by other law of the enacting State (for example, aircraft equipment covered by the Cape Town Convention/Aircraft Protocol) or raise concerns that are more appropriately dealt with by a more specialized regime (for example, investment securities covered by the Geneva Securities Convention). However, any additional exceptions (e.g., employment benefits), should be narrow and clearly specified in the law (see *Secured Transactions Guide*, chap. I, para. 44 and recs. 4 and 7).

3. Creation of a security right

22. The *Secured Transactions Guide* recommends that a distinction should be drawn between the creation of a security right (effectiveness between the grantor and the secured creditor) and its effectiveness against third parties (see *Secured Transactions Guide*, chap. I, paras. 1-7, chap. III, paras. 6-8, and recs. 1, subpara. (c), 13 and 30). The main reason for this approach is to enable parties to create a security right in their assets in an uncomplicated and efficient manner (see *Secured Transactions Guide*, recs. 1, subpara. (c), and 13).

23. Thus, the *Secured Transactions Guide* imposes minimum formalities on the creation of a security right. It recommends that: (a) a security right may be created simply by an agreement between the grantor and the secured creditor; (b) the agreement must indicate the intent of the parties to create a security right, identify the parties and describe the secured obligation and the encumbered assets (but there are no other requirements); (c) the agreement must be in a writing that indicates the grantor's intent to create a security right only if it is not accompanied by a transfer of actual possession of the encumbered asset to the secured creditor; and (d) the required form of writing is flexible and includes electronic means of communications (see *Secured Transactions Guide*, recs. 11-15).

24. By dispensing with the need for a transfer of possession of the encumbered assets to create a security right, the secured transactions law contemplated by the *Secured Transactions Guide* enables an enterprise to encumber not only its tangible existing assets but also its intangible and future assets, as well as pools of circulating assets, including, most significantly, receivables and inventory (see *Secured Transactions Guide*, chap. II, paras. 49-70 and recs. 2 and 17). Under the recommendations of the *Secured Transactions Guide*, a security right in future assets is created as soon as the grantor acquires rights in the assets (see *Secured Transactions Guide*, rec. 13). It also permits an enterprise to continue to retain possession of and to use its tangible encumbered assets. This approach is likely to increase access to credit by expanding the range of assets that a grantor can offer as security. The recommendations of the *Secured Transactions Guide* further confirm that a security right may secure any type of obligation, including future and indeterminate obligations (see *Secured Transactions Guide*, rec. 16).

25. This recognition by the *Secured Transactions Guide* of non-possessory security rights also enhances consumer access to credit since it enables consumer grantors to take immediate possession of assets acquired on secured credit terms. The *Secured Transactions Guide*, however, is mindful of the need to preserve the rights of consumers and other persons that may require special protection. Thus, it recommends that the secured transactions law should not affect the rights of consumers under consumer protection legislation or override statutory limitations on the types of asset that may be transferred or encumbered (see *Secured Transactions Guide*, chap. I, paras. 10 and 11; chap. II, paras. 56, 57 and 107; recs. 2, subpara. (b) and 18).

26. The *Secured Transactions Guide* also confirms that, unless otherwise agreed, a security right automatically continues in any proceeds of the encumbered assets (and proceeds of proceeds) without the need for a specific agreement with respect to the proceeds (see *Secured Transactions Guide*, rec. 19). This approach is consistent with the expectations of the parties (see *Secured Transactions Guide*, chap. II, paras. 72-81).

4. Third-party effectiveness of a security right

27. Under the recommendations of the *Secured Transactions Guide*, a security right becomes effective between the parties as soon as the requirements for creation outlined above are satisfied. However, the security right cannot be set up against rights acquired by third parties in the encumbered assets unless and until the requirements for third-party effectiveness of the security right are satisfied. The reason for this distinction is to ensure that the security right created by the parties' private agreement is adequately publicized to third parties that might be negatively affected by its existence.

28. Registration of a notice in a general security rights registry is the main method recognized by the *Secured Transactions Guide* for achieving the third-party effectiveness of a security right (see *Secured Transactions Guide*, rec. 32). While this is the only method of achieving third-party effectiveness of a security right that is available for all types of encumbered asset, the *Secured Transactions Guide* recognizes other methods for specific types of encumbered asset.

29. First, the dispossession of the grantor qualifies as an alternative method of achieving third-party effectiveness, provided that the dispossession is actual (not constructive, fictive deemed or symbolic). The transfer of possession of the encumbered assets to the secured creditor or its representative is considered to be sufficient practical notice to third parties that the grantor's rights in the assets are likely to be encumbered (see *Secured Transactions Guide*, Introduction, sect. B, "possession" and rec. 37). Since physical dispossession is required, this method of achieving third-party effectiveness is available only for the tangible assets of a grantor that the grantor owns at the time of the conclusion of the security agreement and then only if, as a practical matter, the grantor is prepared to relinquish possession.

30. Second, the *Secured Transactions Guide* recommends that, where the encumbered asset is a right to payment of funds credited to a bank account or a right to receive the proceeds of a letter of credit, secured creditors should be given the option of achieving third-party effectiveness by taking "control" of the encumbered asset in lieu of registration in the general security rights registry (see *Secured Transactions Guide*, Introduction, sect. B, "control" and rec. 103).⁹

31. Third, the *Secured Transactions Guide* may apply to security rights in types of asset that are subject to a specialized registration regime, such as motor vehicles, ships, aircraft and intellectual property (see *Secured Transactions Guide*, chap. I, paras. 32-36, and rec. 4, subparas. (a) and (b)). To the extent that the *Secured Transactions Guide* applies to security rights in these types of asset, it recommends that registration in the specialized registry should be recognized as an alternative method of achieving third-party effectiveness (see *Secured Transactions Guide*, rec. 38).

32. Fourth, where the encumbered movable asset is at the time of the conclusion of the security agreement or may be subsequently attached (and does become attached) to immovable property, the *Secured Transactions Guide* recommends that the security right may be made effective against third parties by registration in either the general security rights registry or the immovable property registry (see *Secured Transactions Guide*, rec. 43; as to the priority implications of the choice of registration venue, see para. 40 below).

5. Priority of a security right

(a) Competing security rights

33. If more than one security right created by the same grantor in the same encumbered asset has been made effective against third parties, it is necessary to have a priority rule to rank the competing security rights (see *Secured Transactions Guide*, chap. III, paras. 12-14). Where the competing security rights were all made effective against third parties by registration, priority is generally determined by the temporal order of registration (see *Secured Transactions Guide*, rec. 76, subpara. (a)). Where the competing security rights were all made effective against

⁹ It should be noted that securities, payment rights arising under or from financial contracts governed by netting agreements and payment rights arising under or from foreign exchange contracts are excluded from the scope of the *Secured Transactions Guide* (see *Secured Transactions Guide*, chap. I, paras. 37-39, and rec. 4, subparas. (c)-(e)). For these types of encumbered asset, the enacting State may wish to consider enacting specialized rules.

third parties otherwise than by registration, priority is generally determined by the temporal order of when third-party effectiveness was achieved (see *Secured Transactions Guide*, rec. 76, subpara. (b)). In the event a security right that was made effective against third parties otherwise than by registration (e.g. by delivery of possession) comes into competition with a security right that was made effective against third parties by registration, priority is generally determined by the respective temporal order of registration or when the third-party effectiveness was otherwise established (see *Secured Transactions Guide*, rec. 76, subpara. (c)).

34. Although these recommendations provide the baseline rules, a modern secured transactions law along the lines recommended in the *Secured Transactions Guide* will invariably recognize exceptions in the interest of facilitating other business practices and policy objectives. The following paragraphs summarize the principal exceptions recognized by the *Secured Transactions Guide*.

35. First, the *Secured Transactions Guide* recognizes a special priority in favour of a secured creditor that finances the grantor's acquisition of tangible assets (for example, consumer goods, equipment or inventory) or intellectual property (see *Secured Transactions Guide*, chap. X, paras. 125-139, and *Supplement*, paras. 181-183). Provided that the requirements recommended by the *Secured Transactions Guide* for obtaining this special priority are satisfied (that is, registration of a notice and, in the case of inventory, possibly notification of inventory financiers of record; see rec. 180, alternative A, subpara. (b), and alternative B, subpara. (b)), the "acquisition security right" has priority with respect to the value of those assets over security rights in the grantor's future assets of that kind that were previously acquired and registered or otherwise made effective against third parties. This approach does not prejudice the prior secured creditor since the grantor would likely not have been able to acquire these new assets but for the new financing. Giving priority to acquisition security rights also benefits the grantor by giving it access to diversified sources of secured credit to finance new acquisitions.

36. Second, a security right in money and in negotiable instruments or negotiable documents that is made effective against third parties by a transfer of possession to the secured creditor has priority over a security right that was previously made effective against third parties by registration (see *Secured Transactions Guide*, recs. 101, 102, 108 and 109). This exception is based on the policy of preserving the free negotiability of these types of asset in the market place.

37. Third, where the encumbered asset is the right to payment of funds credited to a bank account or a right to receive the proceeds of a letter of credit, a secured creditor that achieves priority by taking "control" of the encumbered asset has priority over a prior or subsequent security right that is made effective against third parties by registration (see *Secured Transactions Guide*, Introduction, sect. B, "control" and recs. 103 and 107). As already mentioned (see footnote 9 above), securities, payment rights arising under or from financial contracts governed by netting agreements and payment rights arising under or from foreign exchange contracts are excluded from the scope of the *Secured Transactions Guide* (see *Secured Transactions Guide*, chap. I, paras. 37-39, and rec. 4, subparas. (c)-(e)). Enacting States will need to enact special priority rules in relation to these types of asset.

38. Fourth, to the extent that the secured transactions law applies to security rights in types of movable asset that are subject to specialized registration systems, such as motor vehicles, ships, aircraft and intellectual property (see *Secured Transactions Guide*, chap. I, paras. 32-36, and rec. 4, subparas. (a) and (b)), the *Secured Transactions Guide* recommends that priority should be given to a security right that was made effective against third parties by registration in the specialized registry as against a security right registered in the general registry; where both security rights are registered in the specialized registry, it recommends that priority should be determined by the order of registration in the specialized registry (see *Secured Transactions Guide*, recs. 77 and 78). These rules are designed to preserve the reliability and comprehensiveness of the specialized registry record.

39. Fifth, the *Secured Transactions Guide* adopts a similar approach to priority competitions involving competing security rights in attachments to immovable property. It recommends that priority should be given to a security right, notice of which was registered in the immovable property registry, over a security right in the attachment, notice of which was registered only in the general security rights registry; where notice with respect to both competing security rights was registered in the immovable property registry, it recommends that priority should be determined by the order of registration (see *Secured Transactions Guide*, recs. 87 and 88). These rules are likewise designed to preserve the reliability and comprehensiveness of the immovable property registry record.

(b) Buyers or other transferees of encumbered assets

40. As a general rule, the *Secured Transactions Guide* recognizes that a secured creditor that has complied with the requirements for third-party effectiveness with respect to its security right has a “right to follow” the encumbered asset into the hands of a buyer or other transferee from the grantor that acquires rights in the encumbered asset (see *Secured Transactions Guide*, chap. II, paras. 72-89, chap. III, paras 15, 16 and 89, and rec. 79). Conversely, a transferee of an encumbered asset will take it free of a security right that has not been made effective against third parties by registration or by some other method even if it has knowledge of the existence of the security right (under the *Secured Transactions Guide*, “knowledge” means actual knowledge; see Introduction, sect. B). This approach is not unfair to secured creditors since they could have protected themselves by timely registration or by otherwise making their security right effective against third parties. However, the *Secured Transactions Guide* recognizes a number of exceptions to this general rule. The following paragraphs summarize the principal exceptions.

41. First, where a secured creditor authorizes the grantor to sell, lease or licence an encumbered asset free of a security right, the rights of a buyer or lessee or licensee are unaffected by the security right (see *Secured Transactions Guide*, rec. 80). Typically, the secured creditor will give its consent only after some arrangement has been made with the grantor to provide other security such as ensuring that the proceeds of the transaction will be remitted directly to the secured creditor.

42. Second, a buyer or lessee or licensee that acquires an encumbered asset in the ordinary course of the grantor’s business acquires rights unaffected by any security right in that asset even if the secured creditor has registered a notice of the security right or otherwise complied with the requirements for third-party effectiveness

(see *Secured Transactions Guide*, rec. 81). This approach is consistent with the reasonable commercial expectations of the parties involved. For example, it is not realistic to expect buyers dealing with a commercial enterprise which routinely sells the types of asset in which the buyer is interested to check the registry before entering into the transaction. Moreover, a secured creditor that takes a security right in a grantor's inventory will normally have done so on the expectation that the grantor will dispose of the inventory free of the security right in the ordinary course of the grantor's business. After all, for the grantor to be able to generate the revenue necessary to pay back the secured loan, its customers need to be assured that they will acquire unencumbered title in any inventory sold to them in the grantor's ordinary course of business.

43. Third, the same policy of preserving negotiability that justifies awarding a special priority to secured creditors that take physical possession of encumbered assets in the form of money or negotiable documents (such as a bill of lading) or negotiable instruments (such as a cheque) also justifies awarding priority to outright transferees of these types of encumbered asset who take possession (see *Secured Transactions Guide*, recs. 101, 102, 108 and 109).

44. Fourth, as already mentioned, the *Secured Transactions Guide* may apply to assets that are subject to a specialized registration regime, such as motor vehicles, ships, aircraft and intellectual property (see *Secured Transactions Guide*, chap. I, paras. 32-36, and rec. 4, subparas. (a) and (b)). These registries typically serve broader goals than simply publicizing security rights in the relevant assets, notably, also recording ownership or transfers of ownership. Accordingly, to the extent that the *Secured Transactions Guide* applies to security rights in these types of asset, it recommends that priority should be given to the rights of a buyer or other transferee with respect to which a notice was registered in the specialized registry as against a security right with respect to which a notice was registered in the general security rights registry; where a notice with respect to the security right is also registered in the specialized registry, it recommends that priority should be determined by the order of registration (see *Secured Transactions Guide*, recs. 77 and 78).

45. Fifth, a similar approach is taken to priority competitions involving security rights in attachments to immovable property. The *Secured Transactions Guide* recommends that priority should be given to the rights of a buyer or other transferee of the relevant immovable property with respect to which a notice was registered in the immovable property registry as against a security right in the attachment with respect to which a notice was registered only in the general security rights registry; where a notice with respect to the security right in the attachment is also registered in the immovable property registry, it recommends that priority should be determined by the order of registration in the immovable property registry (see *Secured Transactions Guide*, recs. 87 and 88).

(c) Unsecured creditors of the grantor

46. One of the principal advantages of taking security is that it entitles the secured creditor to claim the value of the encumbered assets in preference to the claims of the grantor's unsecured creditors. Accordingly, the *Secured Transactions Guide* recommends that a security right has priority over the rights of an unsecured creditor provided that the secured creditor registers or otherwise makes its security right effective against third parties before the unsecured creditor obtains a

judgement or provisional court order against the grantor and takes the steps necessary under other law of the enacting State to acquire rights in the encumbered assets (see *Secured Transactions Guide*, rec. 84). This approach enables unsecured creditors to determine the extent to which their debtors' assets may be encumbered in order to decide whether it is worthwhile to obtain a judgement and pursue judgement enforcement proceedings. This priority rule, however, is subject to an important caveat. Even if the secured creditor registers a notice of its security right or otherwise achieves third-party effectiveness after the unsecured creditor acquires rights in its debtor's encumbered assets, the secured creditor will have priority to the extent of credit that it advances before it has knowledge that the unsecured creditor has acquired rights in the encumbered assets or that it advances pursuant to a prior irrevocable commitment to extend credit to the grantor (see *Secured Transactions Guide*, chap. V, paras. 94-106, and rec. 84).

47. The *Secured Transactions Guide* discusses but does not make any recommendation with respect to the steps that an unsecured creditor must take to acquire rights in its debtor's assets so as to potentially prevail over a secured creditor that has failed to achieve third-party effectiveness at all or in time (see *Secured Transactions Guide*, chap. V, paras. 94-106). This is left to the judgement enforcement and execution law of the enacting State. In some States, an unsecured creditor acquires rights in its debtor's assets only once the judgement enforcement process is completed by seizure and sale and the judgement creditor's rights attach to the proceeds of the sale. In other States, an unsecured creditor upon obtaining judgement can obtain the equivalent of a general security right in the judgement debtor's present and future movable assets simply by registering a notice of the judgement in the general security rights registry. Accordingly, States enacting the general recommendations of the *Secured Transactions Guide* will need to take into account their existing law on this issue and decide on the most appropriate approach.

(d) The insolvency representative

48. Modern insolvency laws generally respect the priority to which secured creditors are entitled under other law in the event that insolvency proceedings are commenced against the grantor. This is the approach recommended in the *Secured Transactions Guide* (see *Secured Transactions Guide*, rec. 239) in line with the UNCITRAL Legislative Guide on Insolvency Law (the "Insolvency Guide"). It follows that a secured creditor generally will have priority over the claims of an insolvent grantor's unsecured creditors, provided that the secured creditor registered or otherwise satisfied the third-party effectiveness requirements of secured transactions law before the commencement of the insolvency proceedings. Conversely, the failure of the secured creditor to register a notice or otherwise make its security right effective against third parties before the commencement of the insolvency proceedings generally results in the secured creditor being effectively demoted to the status of an unsecured creditor.

49. Timely registration does not, however, protect a secured creditor from challenges on the basis of general insolvency law policies, such as rules avoiding preferential or fraudulent transfers and rules giving priority to certain protected classes of creditors (see *Secured Transactions Guide*, chap. XII, and rec. 239; see also *Insolvency Guide*, recs. 88 and 188).

50. A security right that was effective against third parties at the time of the commencement of the insolvency proceedings might lapse thereafter, for example, because it was made effective against third parties by registration and the period of effectiveness of the registration expired. To address this risk, the *Secured Transactions Guide* recommends that a secured creditor should be entitled to take any action required by the secured transactions law to preserve the effectiveness of its security right against third parties even after the commencement of insolvency proceedings (see *Secured Transactions Guide*, rec. 238). This recommendation is designed to ensure that a secured creditor is not denied the ability to maintain its priority status as a result of the automatic stay typically imposed on enforcement action by creditors upon the commencement of insolvency proceedings.

51. Where the insolvency proceeding takes the form of a reorganization, modern insolvency laws generally authorize the insolvent grantor to create a security right in the assets of the insolvency estate to obtain post-commencement finance (see *Insolvency Guide*, rec. 65). Under the *Insolvency Guide*, such a security right does not have priority over any existing secured creditors unless agreed to by them or authorized by the court with the appropriate protections for them (see *Insolvency Guide*, recs. 66 and 67).

(e) Preferential claims

52. For various policy reasons, a State's secured transactions law, insolvency law or both may sometimes award preferential priority status to specified categories of unsecured creditors over the claims of secured creditors. Typical examples include the claims of the enacting State for taxes and of employees for unpaid wages or other employment benefits. In addition or alternatively, in the insolvency context, some States set aside a specified portion of the value of encumbered assets, particularly business assets, in favour of unsecured creditors in preference to secured creditors. The *Secured Transactions Guide* discusses preferential claims and recommends that, to the extent an enacting State decides to maintain any, they should be limited in both type and amount and prescribed in the secured transactions law and the insolvency law, as the case may be, in a clear and specific way (see *Secured Transactions Guide*, chap. V, paras. 90-93, and chap. XII, paras. 59-63, and recs. 83 and 239). The reason why the *Secured Transactions Guide* follows this approach is twofold. On the one hand, the *Secured Transactions Guide* is mindful of the social policies enacting States may wish to pursue with preferential claims. On the other hand, the *Secured Transactions Guide* recognizes that preferential claims may have an impact on the cost and availability of credit.

53. In some States, while a notice with respect to preferential claims may be registered in the general security rights registry, the registration and priority rules that apply to security rights created by a voluntary security agreement may not necessarily apply. The *Secured Transactions Guide* discusses but does not make any recommendation with respect to whether notices with respect to preferential claims should be registered and what the priority implications of registration should be (see *Secured Transactions Guide*, chap. V, para. 90).