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Draft legislative guide on secured transactions

Report of the Secretary-General

Addendum

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III. Basic approaches to security

A. General remarks

1. Introduction

1. Over time, a broad variety of practices have been developed in different countries to secure a creditor's claims (usually for monetary payment) against its debtor. It is the purpose of this chapter to provide a broad survey of the various major approaches for affording the creditor effective means of security; the advantages and disadvantages of each approach to both the immediate parties involved, i.e. creditor and debtor, and third parties; and the major policy options for legislators.

2. In a general sense, it is possible to distinguish three major types of instruments that are used for the purposes of security. These are, first, instruments designed for and openly denominated as security (see section A.2); second, the recourse to title (ownership) for purposes of security combined with various types of contractual arrangements (see section A.3); and, third, a uniform comprehensive security (see section A.4).

2. Instruments traditionally designed for security

a. Security rights in tangible movable property

3. Traditionally, most countries distinguish between proprietary security rights in tangible movable property ("tangibles"; see section A.2.a) and those in intangible movable property ("intangibles"; see section A.2.b). In fact, the tangible nature of an asset gives rise to forms of security that are not available for intangibles (see paras. 8, and 25-26).

4. Within the group of security rights in tangibles, most countries draw a distinction based upon whether the encumbered assets must be transferred into the possession of the creditor (or a third party) or whether the debtor (or a third party) granting the security can retain possession. The former alternative is designated as possessory security (see section A.2.a.i) and the latter alternative as non-possessory security (see section A.2.a.ii).

i. Possessory security

(a) Pledge

5. By far the most common (and also ancient) form of possessory security in tangibles is the pledge. A pledge requires for its validity that the debtor (references to "the debtor" should be understood as references to "the grantor" where security is granted by a third party in favour of the debtor) effectively give up possession of the encumbered tangibles and that these be transferred either to the secured creditor or to a third party agreed upon by the parties (e.g. a warehouse). The actual holder may also be an agent or trustee who holds the security in the name, or at least for the account, of the creditor or a syndicate of creditors. The required dispossession of the debtor must not only occur at the creation of the security right but it must be

maintained during the life of the pledge; return of the encumbered assets to the debtor usually extinguishes the pledge.

6. Dispossession need not always require physical removal of the encumbered assets from the debtor's premises, provided that the debtor's access to them is excluded in other ways. This can be achieved, for example, by handing over the keys to the rooms in which the encumbered assets are stored to the secured creditor, provided that this excludes any unauthorized access by the debtor.

7. The debtor's dispossession can also be effected by delivering the encumbered assets to, or by using assets that are already held by, a third party. Examples are merchandise or raw materials stored in a warehouse or a tank of a third party. An institutional (and more expensive) arrangement may be involving an independent "warehousing" company, which exercises control over the pledged assets as agent for the secured creditor. For this arrangement to be valid, there cannot be any unauthorized access by the debtor to the rooms in which the pledged assets are stored. In addition, the warehousing company's employees must not work for the debtor (if they are drawn from the debtor's workforce, because of their expertise, they may no longer work for the debtor).

8. In the case of assets of a special nature, such as documents and instruments (whether or not negotiable), that embody rights in tangible assets (e.g. bills of lading or warehouse receipts) or intangible rights (e.g. negotiable instruments, bonds or share certificates), dispossession is effected by transferring the documents or instruments to the secured creditor. However, in this context, the line between possessory and non-possessory security may not always be easy to draw.

9. In view of the debtor's dispossession, the possessory pledge presents three important advantages for the secured creditor. First, the debtor is unable to dispose of the pledged assets without the secured creditor's consent. Second, the creditor does not run the risk that the actual value of the encumbered assets will be reduced through the debtor neglecting upkeep and maintenance. Third, if enforcement becomes necessary, the secured creditor is saved the trouble, time, expense and risk of having to claim delivery of the encumbered assets from the debtor.

10. Possessory security has also advantages for third parties, especially the debtor's other creditors. The required dispossession of the debtor avoids any risk of creating a wrong impression of wealth and also minimizes the risk of fraud.

11. On the other hand, the possessory pledge has also major disadvantages. The greatest disadvantage for the debtor is the required dispossession, which precludes the debtor from using the encumbered assets. Dispossession is particularly troublesome in situations where possession of the encumbered assets is indispensable for commercial debtors who require these assets to generate the income from which to repay the loan (as is the case, for example, with raw materials, semi-finished goods, equipment and inventory).

12. For the secured creditor, the possessory pledge has the disadvantage that it has to store, preserve and maintain the encumbered assets, unless a third party assumes this task. Where secured creditors themselves are neither able nor willing to assume these tasks, entrusting third parties will involve additional costs that will be directly or indirectly borne by the debtor. Another disadvantage is the potential liability of the secured creditor in possession of encumbered assets (e.g. pledgee, holder of a

warehouse warrant or a bill of lading) that might have caused damage. This is a particularly serious problem in the case of liability for contamination of the environment, since often the monetary consequences (cleanup, damages) substantially exceed the value of the encumbered asset, let alone the prejudice to the reputation and image of the lender. Very few laws address environmental liability of secured creditors in possession. Some of them expressly exempt secured creditors from liability. Other laws limit such liability under certain conditions. When no such exemption from or limitation of liability exists, the risk may be too high for a lender to accept to extend credit or, at least, require insurance, which to the extent it is available, will significantly increase the cost of the transaction to the debtor.

[*Note to the Working Group: The Working Group may wish to define the limits of secured creditors' liability and establish safe harbours for creditors in connection with their entering into possession of encumbered assets to protect their security right, whether when taking a possessory security or upon enforcement of a non-possessory security.*]

13. However, where the parties are able to avoid the aforementioned disadvantages (see paras. 11-12), the possessory pledge can be utilized successfully. There are two major fields of application. First, where the encumbered assets are already held by or can easily be brought into the possession of a third party, especially a commercial keeper of other persons' assets. The second field of application is where instruments and documents, embodying tangible assets or intangible rights, can be easily kept by the secured creditor itself.

(b) Right of retention of possession

14. Statutory rights of retention are not discussed since, with few exceptions, statutory rights are outside the scope of this Guide (see A/CN.9/WG.VI/WP.6/Add.1, para. 8). A right of retention created by agreement allows a party whose contractual partner is in breach of contract to withhold its own performance and, in particular, an asset which under the terms of the contract the withholding party is obliged to deliver to the party in breach. For example, a bank need not return securities it holds for its customer or allow withdrawals from the customer's bank account, if the customer is in default on repayment of a credit and had agreed to grant the bank a right of retention. Where such a right of retention is reinforced by a valid power to sell the retained item, some legal systems regard such a reinforced right of retention as a pledge, although the method of its creation deviates from that of the pledge proper (see paras. 5-8). Alternatively, a reinforced right of retention may be regarded as having some of the effects of a pledge. The most important consequence of such an assimilation to a pledge is that the creditor in possession has a priority in the assets retained, unless they are subject to an earlier created and effective non-possessory security right.

ii. Non-possessory security

15. As noted above (see para. 11), a possessory pledge of tangibles required for production or sale (such as equipment, raw materials, semi-finished goods and inventory) is economically impractical. These goods are necessary for the entrepreneurial activity of commercial debtors. Without access to, and the right and power of disposition over those assets, the debtor would not be able to earn the

necessary income to repay the loan. This problem is particularly acute for the growing number of commercial debtors who do not own immovables that can be used as security.

16. To address this problem, laws, especially in the last fifty years, began providing for security in movable assets outside the narrow confines of the possessory pledge. While some countries introduced a new security right encompassing various arrangements serving security purposes, most countries, continuing the tradition of the nineteenth century but disregarding an earlier, more liberal attitude, insisted on the "pledge principle" as the only legitimate method of creating security in movable assets. The English common law "charge" was for some time the only genuine non-possessory security. In the twentieth century, legislators and courts have come to acknowledge the urgent economic need to provide security without recourse, and in addition, to the possessory pledge.

17. Individual countries attempted to find appropriate solutions according to particular local needs and in conformity with the general framework of their legal system. The result is a diverse range of solutions. An external indication of the existing diversity is the variety of names for the relevant institutions, sometimes differing even within a single country, such as: "fictive" dispossession of the debtor; non-possessory pledge; registered pledge; *nantissement*; warrant; *hypothèque*; "contractual privilege"; bill of sale; chattel mortgage; and trust. More relevant is the limited scope of application of the approaches taken. Only a few countries have enacted a general statute on non-possessory security (for a more comprehensive approach, see section A.4). Some countries have two sets of legislation, one dealing with security for financing of industrial and artisan enterprises, the other with security for financing of farming and fishing enterprises. In most countries, however, there is a variety of statutes covering only small economic sectors, such as the acquisition of cars or of machinery, or the production of films.

18. In some countries, there is even some reluctance to allow security rights in inventory. This is sometimes based upon an alleged inconsistency between the creditor's security right and the debtor's right and power to sell which is indispensable for converting the inventory to cash with which to repay a secured loan. Another objection is that the disposition of inventory will often give rise to difficult conflicts between multiple transferees or multiple secured creditors. Yet another possible objection may come from a policy decision to reserve inventory for the satisfaction of the claims of the debtor's unsecured creditors (see A/CN.9/WG.VI/WP.6/Add.5, para. 26, note).

19. Varied as the legislation providing for non-possessory security might be, it shares one common feature, namely that some form of publicity of the security right is usually provided for. The purpose of publicity is to dispel the false impression of wealth which otherwise may be derived from the fact that the security right in assets held by the debtor is not apparent (for a detailed discussion of this matter, see A/CN.9/WG.VI/WP.6/Add.4, paras. …). It is often argued that, in a modern credit economy, parties may assume that assets may be encumbered or may be subject to a retention of title. Such general assumptions, however, are bound to increase the cost of credit, even in cases where the person in possession is the owner and the assets are not encumbered (a risk that can be only partially avoided at the cost of an extensive and costly search). In addition, such assumptions fail to sufficiently protect the secured creditor or other third parties, since they do not reveal the name

of the owner or previous secured creditor, or the amount owed, and they do not provide information as to the asset encumbered. Furthermore, in such a system based on general assumptions, there is no objective basis for a priority system to rank security rights in the same assets and thus debtors may not be able to use the full value of their assets to obtain credit.

20. There appears to be a need to bridge the gap between the general economic demand for non-possessory security with the often limited access to such security under current law. A major purpose of legal reform in the area of secured transactions is to develop suggestions for improvement in the field of non-possessory security and in the related field of security in intangibles (see section A.2.b).

21. While modern regimes demonstrate that difficulties can be overcome, experience has shown that legislation on non-possessory security is more complicated than the regulation of the traditional possessory pledge. This is due mainly to the following four key characteristics of non-possessory security rights. First, since the debtor retains possession, it has the power to dispose of or create a competing right in the encumbered assets, even against the secured creditor's will. This situation necessitates the introduction of rules concerning the effects and priority of such dispositions (see A/CN.9/WG.VI/WP.2/Add.7 on priority). Second, the secured creditor must ensure that the debtor in possession takes proper care of, duly insures and protects the encumbered assets to preserve their commercial value, matters which must all be addressed in the security agreement between the secured creditor and the debtor (see A/CN.9/WG.VI/WP.2/Add.8 on rights and obligations of parties before default). Third, if enforcement of the security becomes necessary, the secured creditor will usually prefer to obtain the encumbered assets. However, if the debtor is not willing to part with those assets, court proceedings may have to be instituted. Proper remedies and possibly an accelerated proceeding may have to be provided for (see A/CN.9/WG.VI/WP.2/Add.9 on default and enforcement). Fourth, the appearance of false wealth in the debtor which is created by "secret" security rights in assets held by the debtor may have to be counteracted by various forms of publicity (see A/CN.9/WG.VI/WP.6/Add.4 on publicity).

22. In light of the generally recognized economic need for allowing non-possessory security and the basic differences between possessory and non-possessory security mentioned above (see para. 21), new legislation will be necessary in many countries. In order to meet this economic need and to promote certainty, such legislation should be uniform, comprehensive and consistent. Legislation that introduces non-possessory security by way of narrow and divergent exceptions to the traditional principle of the possessory pledge, as is the case with some countries, could not achieve this result and should be revised.

23. In view of earlier legislative models (see paras. 16-19), legislators may be faced with three alternatives. One alternative may be to adopt uniform legislation for both possessory and non-possessory security rights (see section A.4). This is the well-considered approach of the Model Inter-American Law on Secured Transactions, adopted in February 2002. Another alternative may be to adopt uniform legislation for non-possessory security rights, leaving the regime on possessory rights to other domestic law. Yet another alternative may be to adopt special legislation allowing non-possessory security for credit to debtors in specific branches of business. The prevailing trend of modern legislation, both at the

national and the international level, is towards a uniform approach at least as far as non-possessory security is concerned. A selective approach is likely to result in gaps, inconsistencies and lack of transparency, as well as in discontent in those sectors of the industry that might be excluded.

b. Security rights in intangible movable property

24. Intangibles comprise a broad variety of rights (e.g. right to the payment of money or the performance of other contractual obligation, such as the delivery of oil under a production contract). They include some relatively new types of asset (e.g. uncertificated securities, held indirectly through an intermediary) and intellectual property rights (i.e. patents, trade marks and copyrights). In view of the dramatic increase in the economic importance of intangibles in recent years, there is a growing demand to use these rights as assets for security. Intangibles, such as receivables and intellectual property rights, are often part of inventory or equipment financing transactions, and often the main value of the security is in those intangibles. Furthermore, intangibles may be proceeds of inventory or equipment. However, this Guide does not deal with securities, since they raise a whole range of issues requiring special treatment and these issues are addressed in texts being prepared by the International Institute for the Unification of Private Law (UNIDROIT) and the Hague Conference on Private International Law. Similarly, this Guide will not deal with security in intellectual property rights either because of their complex and specialized nature. The Guide does, however, discuss security in receivables, i.e. rights to claim payment of money, and rights to claim performance of non-monetary contractual obligations, as well as security in other types of intangibles as proceeds of tangibles or receivables.

25. By definition, intangibles are incapable of (physical) possession. Nevertheless, most codes of the so-called "civil law" countries have dealt with the creation of possessory pledges (see paras. 5-13) at least in monetary claims. Some codes have attempted to create the semblance of dispossession by requiring the debtor to transfer any writing or document relating to the pledged claim (such as the contract from which the claim was derived) to the creditor. However, such transfer does not suffice to constitute the pledge. Rather, the debtor's "dispossession" is, in many countries, replaced (quite artificially) by requiring that a notice of the pledge be given to the debtor of the pledged claim.

26. In some countries, techniques have been developed that achieve ends comparable to those attained by the possession of tangibles. The most radical method is the full transfer of the encumbered right (or the encumbered share of it) to the secured creditor. However, this goes beyond creation of a security right and amounts to transfer of title (see section A.3.a). Under a more restrained approach, title to the encumbered rights is not affected but dispositions by the debtor that are not authorized by the secured creditor are blocked. This technique can be used where a person other than the person owing the performance in which the secured creditor's right is created (the third-party debtor) has the power to dispose of the encumbered right. In the case of a bank account, if the debtor as holder of the account agrees that its account can be blocked in favour of the secured creditor, the latter has the equivalent of possession of a tangible movable. That is even more true if the bank itself is the secured creditor.

27. In modern terminology, such techniques of obtaining "possession" of intangible property are appropriately called "control". The degree of control though may vary. In some cases, the control is absolute and any disposition by the debtor is prevented. In other cases, the debtor is allowed to make certain dispositions or dispositions up to a fixed maximum, as long as the secured creditor has access to the account. Control may be a condition for the validity of a security right (see A/CN.9/WG.VI/WP.6/Add.3, para. …) or priority (see A/CN.9/WG.VI/WP.2/Add.7, para. 12).

28. In the context of efforts to create comprehensive regimes for non-possessory security in tangibles (see section A.2.a), it is common for security in the most important types of intangibles to be integrated into the same legal regime, especially in receivables. This serves consistency since the sale of inventory results, as a rule, in receivables and it is often desirable to extend the security in inventory to the resulting proceeds. The publicity system provided for security in tangibles can perform its salutary functions (for details, see A.CN.9/WG.VI/WP.6/Add.4 on publicity) for security in intangibles, such as receivables, as well. This may have the additional benefit of dispensing with notification of the debtor of receivables, which in certain security transactions involving a pool of assets that are not specifically identified may not be feasible. Even if such notification is feasible, in some legal systems, it may not be desirable (e.g. for reasons of cost or confidentiality).

3. The use of title for security purposes

29. In addition to instruments for security proper (see section A.2), practice and sometimes also legislation has in many countries developed an alternative approach for non-possessory security rights in both tangible and intangible assets, namely title (or ownership) as security (*propriété sûreté*). Title as security can be created either by transfer of title to the creditor (see section A.3.a) or by retention of title by the creditor (see section A.3.b). Both transfer and retention of title enable the creditor to obtain non-possessory security (for the economic need for, and justification of, non-possessory security, see para. 15).

a. Transfer of title to the creditor

30. In the absence of a regime of non-possessory security rights, or to fill gaps or address impediments, courts and legislators in some countries have taken recourse to transfer of title of the assets to the secured creditor.

31. There are two features that make the security transfer of title attractive for creditors in certain jurisdictions. First, the formal and substantive requirements for transferring title in tangibles or intangibles to another person are often less onerous than the requirements for creating a security right. Second, in the case of enforcement and in the debtor's insolvency, a creditor often has a better position as an owner than as a holder of a mere security right, especially where the owner's assets, although in the debtor's possession, do not belong to the insolvency estate whereas the debtor's assets, if merely encumbered by a security right for the creditor, do belong to the estate. In other jurisdictions though there is no difference between title for security purposes and security rights with respect to the requirements for creation or enforcement.

32. The security transfer of title has been allowed by law in some countries and by court practice in other countries. In many other countries, especially from the civil law world, such transfers of title are regarded as a circumvention of the ordinary regime of security instruments proper and are therefore held to be void. Some countries, while allowing a security transfer of title, compromise by reducing its effect to that of an ordinary security, especially where it competes with other creditors of the debtor.

33. Legislators are faced with two policy options. One option is to admit security transfers of title with the (usually) reduced requirements and the greater effects of a full transfer, thus avoiding the general regime for security rights. The other option is to admit security transfers of title, but to limit either the requirements or the effects or both to those of a mere security right. The first option results in enhancing the secured creditor's position (although at the risk of increasing the liability of the creditor, see para. 12), while weakening the position of the debtor and the debtor's other creditors. This solution may make sense if the ordinary security regime for debtor-held security is underdeveloped. Under the second option, a graduated reduction of the secured creditor's advantages and of the other parties' corresponding disadvantages is possible, especially if the requirements of a transfer or its effects or both are limited to those relating to a security right. Any variant of this solution may also counter specific weaknesses of the ordinary regime for non-possessory security. However, generally speaking, in countries with a modern, comprehensive and workable regime for non-possessory security, there is no need for allowing transfer of title as a security device. Further, the system of a uniform comprehensive security (see section G) integrates transfers of title by regarding them as security rights.

b. Retention of title by the creditor

34. The second method of using title as security is by contractual retention of title (reservation of ownership). The seller or other lender of the money necessary to purchase tangible or even intangible assets may retain title until full payment of the purchase price (simple retention of title or "ROT" arrangement). This type of transaction is often called "purchase money financing", (see description and example in A/CN.9/WG.VI/WP.6/Add.1, paras. 16-19).

35. There are several variations of ROT arrangements, including: "all monies" or "current account" clauses, in which the seller retains title until all debts owing from the buyer have been discharged and not just those arising from the particular contract of sale; and proceeds and products clauses, in which title extends to the proceeds and the products of the assets in which the seller retained title. An alternative to a retention of title arrangement with the same economic result is achieved by combining a lease contract with an option to purchase for the lessee (for a nominal value), which may only be exercised after the lessee has paid most of the "purchase price" through rent instalments (see example in A/CN.9/WG.VI/WP.6/Add.1, para. 20). In some cases, where the lease covers the useful life of equipment, it is equivalent to a retention of title arrangement even without an option to buy.

36. Economically, a retention of title arrangement provides a security right which is particularly well adapted to the needs of, and therefore is widely used by, sellers for securing purchase money credit. In many countries, this kind of credit is widely

used as an alternative to bank financing that is not purchase money financing and is given preferential status in view of the importance of small- and medium-size suppliers for the economy. In other countries, banks also provide on a more regular basis purchase money financing, for example, where the seller sells to a bank and the bank sells to buyer with a retention of title or where the buyer pays the seller in cash from a loan and transfers title to the bank as security for the loan. In those countries, this source of credit and its attendant specific security is given special attention.

37. Due to its origin as a term of a contract of sale or lease, many countries regard the retention of title arrangement as a mere quasi-security, and, therefore, not subject to the general rules on security, such as requirements of form, publicity or effects (principally priority). Contrary to the transfer of title, its retention by the creditor has, in many countries, a privileged status. This may be justified by the desire to support normally small- and medium-size suppliers and to promote purchase money financing by suppliers as an alternative to bank credit that is not purchase money financing. This privileged status may also be justified by the fact that the seller, by parting with the sold goods without having received payment, increases the debtor's pool of assets and requires protection.

38. In contrast, a number of jurisdictions do not recognize retention of title clauses, while a number of other jurisdictions even prohibit them. Other countries restrict the scope of application of such clauses by denying them effect with respect to certain assets, especially inventory, on the theory that the seller's retention of title is incompatible with the seller granting to the buyer the right and power of disposition over the inventory.

39. Several policy options may be considered. One option is to preserve the special character of the retention of title arrangement as a title device. Another option might be to limit the effect of the retention of title arrangement to: only the purchase price of the respective asset to the exclusion of any other credit; and/or to the purchased asset to the exclusion of proceeds or products. Yet another option might be to integrate the retention of title arrangement into the ordinary system of security rights. In such a case, one may consider granting certain advantages to the seller-creditor for the policy reasons mentioned above (see para. 36). Yet another option might be to place the retention of title fully on a par with any other non-possessory security.

40. The first two options would preserve or even create a special regime outside a comprehensive system of non-possessory security rights. In particular, the first option provides the seller-creditor with extensive privileges, a result that has consequential disadvantages for competing creditors of the buyer, especially in the case of execution and insolvency. A technical disadvantage of the title approach is that it prevents or at least impedes the buyer from using the purchased assets for granting a second-ranking security to another creditor. Another disadvantage of the title approach is that executions by the buyer's other creditors are impossible or difficult without the seller's consent.

41. The last two options mentioned above (see para. 39) are more in line with a comprehensive system of security rights. These options accept that the seller extending credit deserves a certain privileged position since it parts with the sold goods on credit and purchase money credit should be promoted for economic

reasons. On the other hand, in the interest of competing creditors, the statutory privilege is limited to the purchase price for the specific asset and to the sold goods as such. By contrast, rights in proceeds or products of the purchased goods, or sums owing from the debtor-buyer other than those arising from the particular contract of sale with an ROT clause, do not enjoy such a privilege and are subject to the rules applicable to ordinary security rights (e.g. have priority as of the time the relevant transaction is registered).

42. Converting retention of title to a security right would enhance the position of the buyer-debtor since it would be enabled to create a second-ranking (non-possessory) security right to secure a loan from another creditor. It could also improve the position of other creditors of the buyer-debtor in the case of execution with respect to the encumbered asset and in the case of the debtor's insolvency. The supplier's position would not necessarily be weakened, since: with a few exceptions, in principle only simple ROT clauses enjoy a privileged position; and whether or not the retention of title is assimilated to a security right, the assets subject to it are not necessarily part of the debtor's estate (see A/CN.9/WG.VI/WP.6/Add.5, para. 12). However, the supplier would need to register (see A/CN.9/WG.VI/WP.2/Add.7, para. 23), and "all sums" clauses, proceeds and products would enjoy priority only as of the time of registration.

4. Uniform comprehensive security

43. The idea of a single, uniform, comprehensive security right in all types of assets was first developed in the United States of America in the middle of the twentieth century in the context of the Uniform Commercial Code ("UCC"). The UCC, a model law adopted by all fifty states, created a single, comprehensive security right in movables. Article 9 of the UCC unified numerous and diverse possessory and non-possessory rights in tangibles and intangibles, including transfer and retention of title arrangements, that existed under state statutes and common law. The idea spread to Canada, New Zealand and a few other countries. It is recommended in the Model Law of the European Bank for Reconstruction and Development. The Inter-American Model Law on Secured Transactions follows in many respects a similar approach.

44. Technically, two approaches can be used to achieve a uniform and comprehensive security right. Under one approach, the names of the old security devices are preserved and can be used, such as (possessory) pledge and transfer of title. However, their creation and effects are made subject to one unified set of rules. Under a slightly different approach, a new, comprehensive security right is created. In the end, though, there is no substantive difference between the two approaches.

45. The main feature of a broad approach is that it merges the rules for the traditional possessory pledge with the rules on non-possessory pledge and transfer or retention of title for security purposes. This approach results in the creation of a single and comprehensive security right system, ensuring consistent treatment of different types of security rights. This is to the benefit of debtors, secured creditors and third parties, including the insolvency representative in the debtor's insolvency (or the grantor's insolvency if the debtor and the grantor are two different persons). A creditor who envisages granting a secured loan, need not investigate various alternative security devices and evaluate their respective prerequisites and limits as well as advantages and disadvantages. Correspondingly, the burden borne by the

debtor's creditors or the insolvency representative for the debtor who must consider their rights (and duties), vis-à-vis the secured creditor is lessened if only one regime, characterized by a comprehensive security right, has to be examined rather than several different regimes. Further, this will reduce the cost of creating security and, concomitantly, the cost of the secured credit.

46. In cross-border situations, the recognition of security rights created in another jurisdiction will also be facilitated if the jurisdiction of the new location of encumbered assets has a comprehensive security right. Such a system can much more easily accept a broad variety of foreign security rights, whether of a narrow or an equally comprehensive character.

47. The basic approach does not prevent a legislature from adjusting the contents of the individual provisions implementing so as to reflect its particular policies. For example, within this unitary system, special interests (e.g. for purchase money security) may be addressed by means of priority rules (see A/CN.9/WG.VI/WP.2/Add.7, paras. 19-24).

B. Summary and recommendations

48. In certain, albeit limited, practical situations, the possessory pledge functions usefully as a strong security right (see para. 13).

[*Note to the Working Group: The Working Group may wish to consider recommending to States to include in their secured transactions laws or in their environmental laws a rule exempting the secured creditor from liability (or limiting such liability under certain conditions) that may arise from the secured creditor obtaining possession of encumbered assets in the case of possessory pledges. The same exemption (or limitation of liability) could also apply to creditors with a non-possessory security right seeking to enforce their security right upon default, including when engaging, prior to enforcement, in workout activities involving the encumbered assets or the facility where the encumbered assets are stored. Such an exemption or limitation of liability may be limited to secured creditors that have not operated, managed or exercised decision-making control over the facility where the encumbered assets are located.*]

49. A right of retention of possession created by agreement, if accompanied by the creditor's power of sale, functions as a possessory pledge (see para. 14).

[*Note to the Working Group: The Working Group may wish to consider subjecting such a right of retention to the same rules that govern possessory pledges, perhaps with the exception of the rules governing the creation of such rights of retention.*]

50. Non-possessory security rights are of utmost importance for a modern and efficient regime of secured transactions. Debtors need to retain possession of encumbered assets and secured creditors need to be protected against competing claims in the case of debtor default and in particular insolvency (see para. 15).

51. In light of the growing importance of intangibles as security for credit, and the often insufficient rules applicable to this type of security, it would be desirable to

develop a modern legal regime for security in intangibles, especially for receivables (see para. 28).

[*Note to the Working Group: To ensure consistency, the Working Group may wish to consider that a regime for security rights in certain types of intangibles should be as close as possible to that for non-possessory security in tangibles.*

The Working Group may also wish to discuss the conclusions to be arrived at in the Guide with respect to particular types of intangibles, such as receivables. In its discussion of this matter, the Working Group may wish to take into account: other work of UNCITRAL and work of other organizations; the fact that intangibles may be taken as security in the context of transactions relating to security in tangibles (e.g. inventory or equipment financing) or may be proceeds of tangibles; and the complexity and feasibility of a regime on security rights in intangibles.]

52. The transfer of title for security purposes does not appear to be useful where there is an efficient and effective regime of non-possessory security in tangible and intangible assets (see para. 33).

53. If the retention of title (or reservation of ownership) is treated as a mere security device, the seller-creditor or other provider of purchase money should be conferred a special priority equivalent to that of a holder of title.

[*Note to the Working Group: The Working Group may wish to consider whether such a special priority should be limited to the sold asset and/or to its outstanding purchase price (to the exclusion of proceeds and products, as well as of other sums owing from the debtor, see para. 40). The Working Group may also wish to consider that treating the retention of title as equivalent to an "ordinary" security right should not prejudice its qualification for other purposes (e.g. taxation, accounting, etc.).*]

54. There are good reasons for replacing a regime of security rights consisting of a variety of specific security devices by a general, comprehensive security right (see paras. 45-47).

[*Note to the Working Group: The Working Group may wish to consider the advantages and disadvantages of the approach taken in several modern security laws that introduce a uniform comprehensive security right (see paras. 43-47).*]