United Nations A/CN.9/932

General Assembly

Distr.: General
18 December 2017

Original: English

United Nations Commission on International Trade Law
Fifty-first session
New York, 25 June–13 July 2018

Report of Working Group VI (Security Interests) on the work of its thirty-second session (Vienna, 11–15 December 2017)

I. Introduction

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

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

II. Organization of the session

3. The Working Group, which was composed of all States members of the Commission, held its thirty-second session in Vienna from 11 to 15 December 2017. The session was attended by representatives of the following States members of the Working Group: Armenia, Australia, Belarus, Brazil, Bulgaria, Canada, Chile, China, Colombia, Czechia, Ecuador, El Salvador, France, Germany, Greece, Hungary, India, Indonesia, Italy, Japan, Kenya, Kuwait, Malaysia, Mexico, Panama, Philippines, Poland, Republic of Korea, Romania, Russian Federation, Spain, Switzerland,

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

Thailand, Turkey, Uganda, United Kingdom of Great Britain and Northern Ireland, United States of America and Venezuela (Bolivarian Republic of).

4. The session was attended by observers from the following States: Algeria, Belgium, Bolivia (Plurinational State of), Cyprus, Democratic Republic of the Congo, Dominican Republic, Malta, Peru, Saudi Arabia, Slovakia, Syrian Arab Republic and Turkmenistan.

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

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

(b) *Intergovernmental organizations*: European Investment Bank (EIB);

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

6. The Working Group elected the following officers:

Chairperson: Mr. Bruce WHITTAKER (Australia)

Rapporteur: Mr. André João RYPL (Brazil)

7. The Working Group had before it the following documents: A/CN.9/WG.VI/WP.74 (Annotated Provisional Agenda) and A/CN.9.WG.VI/WP75 (Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions: Annotated List of Contents).

8. The Working Group adopted the following agenda:

1. Opening of the session and scheduling of meetings.
2. Election of officers.
3. Adoption of the agenda.
4. Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions.
5. Future work.
6. Other business.
7. Adoption of the report.

III. Deliberations and decisions

9. The Working Group considered the note by the Secretariat entitled “Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions: Annotated List of Contents” (A/CN.9.WG.VI/WP.75). The deliberations and decisions of the Working Group are set forth below in chapter IV. At the close of its session, the Working Group requested the Secretariat to prepare a first draft of the Practice Guide reflecting the deliberations of the Working Group. It was agreed that the Secretariat should be given flexibility in further consulting with experts and practitioners in the relevant areas and in structuring the material in that first draft of the Practice Guide.

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

A. Preliminary considerations (A/CN.9/WG.VI/WP.75, paras. 5–15 and 75–84)

10. At the outset of its deliberations, the Working Group was reminded of the mandate given to it by the Commission as well as the flexibility given to it in determining the scope, structure and content of the draft Practice Guide. It was stressed that the Working Group should take due caution in addressing issues not specifically dealt with in the Model Law and the UNCITRAL Guide to Enactment on the Model Law (the "Guide to Enactment") as they might not necessarily fall within the mandate. Accordingly, the Working Group had a preliminary discussion on the purpose of the draft Practice Guide to reach some working assumptions on how the Working Group intended to progress in its preparation.

11. It was generally observed that the purpose of the Working Group was not to prepare an official commentary on the Model Law but rather to provide practical guidance to users of secured transactions (for example, parties to secured transactions, other relevant parties affected by those transactions and legal advisors to those parties) in States that have enacted, or were considering enacting, the Model Law. It was stressed that the main objective would be to illustrate how the Model Law operated and how potential users could benefit from such operation (particularly focusing on practical transactional opportunities that would be available under the Model Law). Furthermore, it was widely felt that another key purpose of the draft Practice Guide was to bridge the gap between law and business practice.

Intended audience

12. It was widely felt that the draft Practice Guide could provide guidance to a variety of users in a State that has enacted, or was considering enacting, the Model Law. It was suggested that the Model Law could be used to the greatest extent possible if respective parts of the Practice Guide were drafted towards the specific user groups that the parts were intended to benefit. For example, portions of the draft Practice Guide that would discuss contractual and transactional issues could be drafted with an eye towards businesses, financiers, debtors and other parties that would participate in transactions covered by the Model Law. Similarly, portions of the draft Practice Guide on regulatory issues could be targeted at relevant regulators and financial institutions affected by such regulations.

13. In that context, diverging views were expressed about the extent to which the draft Practice Guide would target other types of users (for example, judges, bailiffs as well as registry operators). One view was that it would not be necessary as existing UNCITRAL texts on secured transactions already provided guidance to those users, whereas another view was that there was merit in providing additional guidance in the draft Practice Guide.

14. Given the variety of levels of familiarity with secured transactions law contemplated by the Model Law among the potential readers of the draft Practice Guide, the need to draft the Practice Guide in a comprehensible manner was noted. In that context, it was suggested that the draft Practice Guide should take into account the needs of those that might not necessarily be familiar with the approaches underlying the Model Law.

15. It was agreed that the draft Practice Guide should aim at providing guidance to users from all legal traditions and regions, irrespective of whether the Model Law had been adopted in the respective jurisdictions.

16. Differing views were expressed with regard to the extent to which the draft Practice Guide should incorporate references to different legal systems. One view was that the draft Practice Guide should focus on elaborating on the unitary, functional

and comprehensive approach of the Model Law without drawing a comparison with other legal systems. A concern was raised that drawing such comparisons would require a lengthy analysis and might not fall within the purpose of the draft Practice Guide. In that context, it was suggested that the draft Practice Guide could highlight some novel features of the Model Law, for example, the registry system as well as the possibility of out-of-court enforcement.

17. Another view was that in order for the draft Practice Guide to highlight the benefits of the Model Law, some comparison with the traditional secured transactions regimes would be useful, particularly by highlighting certain types of transactions that would become possible under the Model Law.

18. It was noted that the Working Group would benefit from a draft text before considering whether to incorporate, and to what extent, references to various legal traditions in the draft Practice Guide. After discussion, it was widely felt that the introductory part of the draft Practice Guide could include a general section on the benefits of the Model Law as well as the approaches therein without references to any other legal system. It was also felt that when the draft Practice Guide provided examples of individual transactions, it could possibly include brief commentary on other traditional approaches.

Scope

19. With regard to contractual and transactional issues to be dealt with in the draft Practice Guide, it was suggested that the draft Practice Guide could provide examples and focus on some key transactions rather than address the entirety of transactions possible under the Model Law. In that context, it was highlighted that the draft Practice Guide should reiterate the general rule in the Model Law that a security right might encumber any type of movable assets subject to the exclusions provided therein. In the same vein, it was noted that the draft Practice Guide should focus on key transactions rather than on transactions involving specific types of assets.

20. It was widely felt that the draft Practice Guide could focus on transactions involving equipment, inventory and receivables, as they constituted core commercial assets for businesses. Noting the increasing importance of intellectual property as collateral, it was generally felt that the draft Practice Guide should also deal with transactions involving intellectual property, which would build upon the Supplement on Intellectual Property.

21. Noting that the Model Law provided asset-specific rules for certain types of assets, it was also mentioned that the draft Practice Guide could possibly address, for example, transactions involving bank accounts. Another suggestion was that the draft Practice Guide could deal with secured transactions involving agricultural and aquaculture products. However, it was reiterated that caution should be taken when focusing on transactions involving specific types of assets as the discussion might run contrary to the unitary and functional approach underlying the Model Law. It was suggested that such transactions should only be addressed to the extent that the nature of those assets required different treatment in structuring the secured transaction.

22. It was also suggested that the draft Practice Guide should not aim at addressing sophisticated financial transactions (in particular, those not involving secured transactions) and insolvency-related financing transactions.

23. With regard to the extent to which the draft Practice Guide should deal with financing in general, it was stated that its focus should be on secured lending and the legal relationships that arose from such transactions (for example, between the secured creditor and the grantor). It was suggested that the draft Practice Guide should not attempt to deal with lending in general, particularly the legal relationship between the lender and the debtor.

24. It was therefore generally felt that the draft Practice Guide should not provide guidance on the fundamentals of good lending practices and that its focus should be

on issues related to secured lending practices, while it might touch upon some general lending practices as relevant to taking a security right.

25. With respect to the extent to which the draft Practice Guide should address regulatory issues, it was generally felt that the Working Group should take due caution so that it did not inadvertently address aspects which were outside its mandate. In that context, it was questioned whether the draft Practice Guide was an appropriate and effective means to address such issues, considering that such regulatory authorities had not taken part in the preparation of the Model Law and that regulations themselves reflected conscious policy decisions. It was also pointed out that in contrast to contractual and transactional issues for which the Working Group had developed relevant principles and rules over the years, regulatory issues had not been considered in depth.

26. Noting that the mandate given to the Working Group included addressing regulatory issues, it was pointed out that one purpose of the Practice Guide would be to support the secured transactions framework contemplated by the Model Law and that in not addressing regulatory aspects, the draft Practice Guide could run contrary to that objective. It was highlighted that the Working Group should not overlook the fact that financial institutions providing secured lending were subject to rigorous financial regulations. It was therefore noted that the draft Practice Guide should draw the attention of its readers to the existence of such regulations, and at the same time inform relevant regulatory authorities on how secured transaction laws contemplated by the Model Law would operate. It was further mentioned that regulatory issues were closely related to transactional issues, in particular, the conditions under which certain types of movable assets were recognized as eligible collateral.

27. On the manner in which regulatory issues would be addressed in the draft Practice Guide, it was suggested that any work by the Working Group should fully respect established international regulatory standards, should not involve substantive discussions about the underlying policies and should not attempt to provide recommendations on such aspects. It was suggested that the material to be prepared should be minimal and explanatory in nature, particularly focusing on the interaction between such regulations and secured transactions law. Recalling that the Working Group had addressed the interaction between secured transactions law and other laws (for example, intellectual property law), it was suggested that the draft Practice Guide should focus on coordination. It was reiterated that lack of coordination might lead regulated financial institutions to treat transactions secured by movable property as being no better for capital adequacy purposes than unsecured credit, which would make it difficult for the Model Law to achieve its objective of enhancing access to credit.

28. In that context, calls for enhanced cooperation between the Secretariat and relevant international regulatory authorities as well as for coordination within national authorities were mentioned. It was suggested that discussions in the Working Group could benefit from input from relevant international as well as domestic regulatory authorities.

29. After discussion, the Working Group reached the working assumption that the draft Practice Guide should address regulatory issues in a brief and explanatory manner, without questioning or making any suggestions regarding the policy underlying such financial regulations. It was emphasized that the focus of the draft Practice Guide should be to address the interaction and coordination between secured transaction laws and relevant financial regulations, including but not limited to the treatment of movable property under the capital adequacy requirements and how the operation of the Model Law could assist in meeting those requirements. In that context, the Secretariat was requested to engage with the Basel Committee on Banking Supervision as well as other relevant international organizations to share information and to seek coordination. Similarly, it was suggested that States should coordinate closely with their domestic regulatory authorities in advance of the relevant discussions in the Working Group.

Structure

30. Diverging views were expressed with regard to the extent to which the draft Practice Guide should be self-contained. One view was that a straightforward text without too many references to other relevant material would make the text easier to comprehend. Another view was that an attempt to produce a self-contained text might inadvertently result in a cumbersome text, which would run contrary to the general understanding that the draft Practice Guide should be simple and concise. In that context, the Working Group considered the utility of reproducing certain text for the benefit of the readers and of using cross-references.

31. After discussion, it was generally agreed that the objective of the Working Group was to prepare a user-friendly Practice Guide and accordingly, it would need to balance the need for it to contain all relevant information and the need to keep it concise. It was also felt that appropriate use of cross-references to UNCITRAL and other texts may enhance the readability of the draft Practice Guide.

32. It was also agreed that the draft Practice Guide should include a short introduction on the Model Law and other relevant UNCITRAL texts, further explaining their relationship and how they related to the draft Practice Guide.

33. On how the draft Practice Guide would deal with diverse types of transactions, as well as a wide range of parties to those transactions, it was generally felt that the draft Practice Guide should begin with providing examples of simple and standard transactions to elucidate the core principles of the Model Law and build upon those examples to illustrate more complex transactions (see also paras. 60–64 below).

34. The Working Group further agreed that the draft Practice Guide would contain separate parts, one dealing with contractual and transactional issues and another dealing with regulatory issues, as each pertained to a different audience.

35. The Working Group then discussed whether the discussion of issues affecting finance to micro-businesses should be dealt with separately or as part of the general discussion of contractual and transactional issues. In that context, the Working Group was informed of the legislative developments currently being undertaken by Working Group I (Micro, Small and Medium-sized Enterprises) to reduce legal and regulatory issues faced by MSMEs and the need to take a consistent approach was emphasized.

36. At the outset, the need for the draft Practice Guide to highlight the importance of finance to micro-businesses, particularly in developing economies, was noted. While acknowledging that the Model Law adequately addressed secured financing to SMEs in general, it was stated that due to the vulnerable nature of micro-businesses and individuals, special considerations needed to be taken into account with regard to their financing in the draft Practice Guide. It was also stated that the draft Practice Guide could draw the attention of potential lenders to micro-businesses.

37. It was also clarified that giving special considerations to micro-businesses would not imply that the draft Practice Guide would deal with micro-finance or unsecured lending to micro-businesses, both of which were outside the mandate of the Working Group. However, it was suggested that to the extent that unsecured lending practices had an impact on secured lending to micro-businesses, the draft Practice Guide could touch upon relevant aspects as many of those issues were intertwined (for example, personal guarantees).

38. While a suggestion was made that there was merit in having a stand-alone portion in the draft Practice Guide to deal comprehensively with issues affecting finance to micro-businesses, it was generally felt that those issues could be dealt with in the portion dealing with contractual and transactional issues. It was stated that most of the contractual and transactional issues would apply similarly to micro-businesses and that from a structural perspective, having a separate portion could be duplicative. In that context, it was suggested that the introduction to the draft Practice Guide could contain a general discussion including how the Model Law could benefit micro-businesses in getting access to financing.

39. After discussion, the Working Group reached a working assumption that issues relating to finance to micro-businesses would be mentioned generally in the introduction to the draft Practice Guide and specific issues that could arise with regard to transactions would be dealt respectively in the portion dealing with contractual and transactional issues. It was further affirmed that the draft Practice Guide would not create a separate secured transactions regime for micro-businesses or suggest any changes to the provisions of the Model Law. In that context, it was widely felt that the introduction to the Practice Guide could outline the following: (i) difficulties micro-businesses face in obtaining credit and the reasons for the draft Practice Guide to address relevant issues; (ii) common features or descriptions of micro-businesses and typical transactions involving micro-businesses; (iii) benefits of the Model Law and opportunities that the implementation of the Model Law would provide to lenders extending credit to micro-businesses as well as to micro-businesses as potential grantors; and (iv) a list of instances where the portion of the draft Practice Guide dealing with contractual and transactional issues included relevant discussions.

Style

40. It was generally felt that, to the extent possible, the draft Practice Guide not be a lengthy and inaccessible text, but rather be simple and concise. It was also emphasized that the draft Practice Guide should be user-friendly. In order to avoid duplication with existing UNCITRAL texts, it was also suggested that cross-references should be included whenever possible.

41. While some concerns were expressed about the use of technical legal terms making it difficult to understand the draft Practice Guide, the need to use consistent terminology as contemplated in the Model Law as well as other UNCITRAL texts was emphasized. In that context, the need to use precise terminology as well as to provide some explanation of other technical terms used in the draft Practice Guide were mentioned. After discussion, it was felt that it would be preferable for the draft Practice Guide to refer to terms already defined in the Model Law and to the extent necessary, provide further elaborations in plain language.

42. With the purpose of making the draft Practice Guide as concise and user-friendly as possible, the Working Group expressed general support for using visual aids (such as text boxes, diagrams and flowcharts) while acknowledging that there might be technicalities to be taken into account.

43. It was generally agreed that the draft Practice Guide should include references to relevant texts of other international organizations, in particular to assist readers where a particular international instrument might become applicable to a certain transaction (for example, the Convention on International Interests in Mobile Equipment and its Protocols and the Unidroit Convention on Substantive Rules for Intermediated Securities) and where such text provided useful guidance.

44. With respect to the use of annexes, it was generally felt that efforts should be made to contain the contents of the draft Practice Guide in the main body of its text, whereas some supporting material (for example, sample templates or forms) could be included as an annex.

45. It was generally understood that the Working Group would aim at preparing the draft Practice Guide as a United Nations publication (also in electronic form). In that context, it was said that the possibility of preparing the Practice Guide as an interactive online interface could be sought, which would nonetheless be subject to obtaining a further mandate from the Commission and identifying available resources.

B. Introduction (A/CN.9/WG.VI/WP.75, paras. 17–29)

Benefits of the Model Law

46. There was general support for the suggested format and content of the introductory portion to be included in the draft Practice Guide. It was also agreed that

the introductory portion should include an explicit statement of the purpose of the Practice Guide. It was also widely felt that the introductory portion should be concise, focusing on the benefits of the Model Law.

47. It was felt that the draft Practice Guide, in illustrating the comprehensive scope of the Model Law, should include a more thorough explanation of its functional approach. It was felt that clear examples highlighting the practical impact of such an approach should be provided, which would also address stakeholder concerns and reactions to the Model Law, particularly during the transition phase. For example, it was stated that users would benefit from an explanation of provisions in the Model Law, which might require certain actions by parties to preserve their rights under the previous regime.

48. In addition, it was said that the draft Practice Guide should provide concrete examples of transactions that were made possible under the Model Law as well as those outlining the consequences of extending the scope of the Model Law to outright transfer of receivables.

49. Regarding the illustration of the registry system as the cornerstone of the Model Law, a number of views were expressed. There was general interest in providing guidance on practical aspects of the registry contemplated by the Model Law, including on how it would be used and how it might differ from other registries (for example, a title registry). While views were expressed that the draft Practice Guide could provide guidance on the general operation of the registry, including coordination with other registries and features that should not be incorporated, it was generally felt that such policy considerations were sufficiently dealt with in the UNCITRAL Guide on the Implementation of a Security Rights Registry. However, it was noted that there might be merit in the draft Practice Guide addressing some practical issues that could arise during the transition phase, for example, with regard to registrations that have been made in specialized registries.

50. With respect to the section on enforcement of security rights, it was said that reference should be made to domestic procedural laws that might become relevant and that emphasis could be put on providing guidance to judges as well as bailiffs.

Cross-border transactions

51. During the discussion, the view was expressed that there would be merit in addressing conflict-of-law issues in the introductory portion, providing guidance to users in determining which law would apply to their transactions. It was stated that even simple transactions (for example, factoring arrangements and transactions involving mobile goods) could raise issues relating to the applicable law.

52. While some support was expressed for that suggestion, it was mentioned that that might overcomplicate the introductory portion and that the Model Law as well as the Guide to Enactment dealt with the issues of conflict-of-law quite comprehensively. It was also mentioned that typical examples to be covered in the draft Practice Guide would not necessarily have a cross-border aspect and that it might be better to address issues arising from cross-border transactions separately in the portion dealing with contractual and transactional issues.

53. After discussion, it was generally felt that the introductory portion of the draft Practice Guide could draw the attention of the readers that there might be issues relating to the applicable law in cross-border transactions and that the portion dealing with contractual and transactional issues could have a stand-alone section illustrating some examples of how the conflict-of-law provisions in the Model Law would operate. It was also widely felt that there would be merit in including cross-references to that stand-alone section to draw the attention of the users to potential difficulties that might arise with respect to cross-border transactions.

Other aspects to be included

54. It was also mentioned that the introductory portion could include the following aspects: (a) illustration of the commercial reasonable standard, and (b) economic analysis that secured transaction reform resulted in increased accessibility of credit.

Key terms

55. There was general support that the draft Practice Guide should include a glossary of key terms used therein, which would build on the definitions already provided in the Model Law and other UNCITRAL texts. It was also felt that the list could be further expanded to the extent necessary to provide additional clarification, including through examples.

Interaction of the Model Law with other laws of the enacting State

56. It was generally felt that issues relating to the interaction of the Model Law with other laws of the enacting State were adequately addressed in the Guide to Enactment and other UNCITRAL texts and need not be replicated in the draft Practice Guide, which was intended to provide practical guidance to users of the Model Law. However, it was also felt that the draft Practice Guide should briefly draw the attention of those users that a secured transaction law implementing the Model Law did not operate in vacuum and that other laws (for example, consumer laws, insolvency laws, contract law and civil procedure law) might be applicable. In that context, it was said that international instruments in force in those jurisdictions might also be applicable and therefore should be mentioned.

57. It was observed that the draft Practice Guide need not reiterate the Guide to Enactment advising legislators to ensure that other laws of that State were amended for their laws as a whole to function in a coordinated manner.

58. It was also agreed that the content and placement of an introductory paragraph on regulatory issues would be considered at a later stage.

C. Contractual and transactional issues (A/CN.9/WG.VI/WP.75, paras. 30–58)

59. It was generally felt that the portion of the draft Practice Guide dealing with contractual and transactions issues (the “Chapter”) could begin with the fundamentals of secured finance under the Model Law, providing a general explanation of the importance of security in movable assets, the requirements for creating a security right and key steps for secured finance transactions. It was generally felt that the Chapter should touch upon different types of transactions possible under the Model Law.

60. With regard to the organization of the material, it was suggested that the Chapter could begin with an example of a simple secured transaction (which the users would be familiar with), provide explanations based on that example, and further build on those explanations to describe more complex transactions. However, diverging views were expressed on such organization as well as on the transaction to be used as an example. It was mentioned that while one type of a transaction might be simpler from a legal perspective, that might not necessarily be so from a transactional/practical perspective.

61. While it was mentioned that there would be benefit in explaining the benefits of creating a security right over certain categories of assets and future assets, it was noted that the introductory portion of the draft Practice Guide would include examples of transactions made possible under the Model Law, albeit in a more general fashion.

62. After discussion, it was generally felt that the Chapter could touch upon the following types of secured transactions:

- A loan secured by an asset currently owned by the grantor

- A loan to finance the purchase of an asset with the security right being taken over that asset (thus, dealing with an acquisition security right)
- A loan secured by all of grantor's assets
- A revolving loan secured by grantor's inventory/receivables
- A sale based on retention-of-title terms
- A loan secured by intellectual property
- A loan secured by negotiable documents
- Lease finance for an item of capital equipment
- Factoring and other purchases of receivables.

63. In that context, it was cautioned that the Chapter should not oversimplify the types of transactions, as the users of the draft Practice Guide would have a certain level of experience with those transactions. Concerns were also expressed that providing too many examples, particularly of transactions involving different types of assets, might confuse the users in understanding the unitary approach of the Model Law.

64. After discussion, the Working Group reached the working assumption that the Chapter would be structured to provide a thorough explanation of a transaction involving a loan secured by an asset owned by the grantor. Building on that explanation, the Chapter would further elaborate on other types of transactions mentioned above (including outright transfer of receivables and retention-of-title transactions), highlighting any differences.

65. During the deliberations, it was pointed out that there could be merit in the draft Practice Guide including references to supply chain financing arrangements and value chain arrangements, which would typically involve a number of different types of transactions mentioned in paragraph 62. It was said that providing such examples would provide the users of the draft Practice Guide a better understanding of how those transactions provided a basis for a broader financing mechanism, which entailed a multitude of transactions involving a number of businesses, including micro-businesses.

How to create and make effective against third parties a security right

66. It was generally felt that the Chapter could include a section explaining the basic requirements that must be satisfied for a secured creditor to obtain an effective security interest, which could focus on the technical requirements, in particular: (a) that the grantor has rights in the asset or the power to encumber it; and (b) that the secured creditor (in most cases) has entered into a written security agreement with the grantor. That section could further explain how possessory pledges operated under the Model Law. It was also widely felt that the Chapter could include a section describing how a security right could be made effective against third parties, mainly by the secured creditor registering a notice in the registry.

Key preliminary steps for secured finance transactions

Due diligence on the customer

67. With regard to the draft Practice Guide addressing due diligence on the customer (the borrower or debtor), a concern was expressed that those issues related to general lending practice and would not fit in a Practice Guide on secured lending (see paras. 23–24 above). Noting that the topic was closely related to the behaviour of, and business decisions by, lenders, it was questioned whether the draft Practice Guide could provide any guidance.

68. However, it was stated that there was a particular need to emphasize the need for due diligence on customers in the context of secured lending practices. This was particularly highlighted with respect to lending to micro-businesses, where there was

an incentive on the lender not to conduct due diligence (as it could be costly), which frequently led to over-collateralisation. It was also stated that the lender might focus merely on the encumbered asset rather than on the ability of the borrower to repay the loan.

69. After discussion, it was widely felt that the Chapter could provide guidance to lenders on the desirability of due diligence on their customers highlighting that taking collateral would not relieve them of the need to conduct due diligence. It was also suggested that the Chapter could provide a checklist for secured creditors, for example, to identify whether the grantor was an individual or a legal entity, whether there were any recent changes in its identifier and whether there had been any other notices registered against the grantor. With regard to micro-businesses, it was generally felt that the draft Practice Guide could address the dangers of over-collateralisation and provide guidance to lenders on the importance of conducting due diligence when lending to micro-businesses.

Due diligence on the asset to be encumbered

70. It was widely felt that the due diligence on the asset to be encumbered was an important aspect to be dealt with in the draft Practice Guide, as they were common to all types of secured transactions. It was felt that emphasis could be placed on the purpose of such due diligence, mainly to reduce the risk of the secured creditor. During the discussion, it was reaffirmed that the purpose of that section would be to provide an explanation of what lenders could do to maximize their benefits in a typical transaction rather than to introduce obligatory requirements.

71. With regard to the verification by the lender that the grantor owned or otherwise had rights in the asset, it was stated that either this section or the section dealing with requirements for the creation of a security right (see para. 66 above) could illustrate that the right of the grantor might not necessarily be a title.

72. It was also mentioned that draft Practice Guide should highlight the fact that a registry as contemplated by the Model Law would provide lenders the ability to determine whether there were any prior security rights registered against the grantor that could apply to the asset.

73. With respect to draft Practice Guide providing guidance that the lender determine whether the asset was adequately insured, it was clarified that that should not inadvertently give the impression that only insured assets qualified as collateral and that only assets that could be insured could be subject of a security right. In that context, the need for the lender to determine whether its security right could extend to the insurance payment was mentioned.

74. During the discussion, it was mentioned that there might be instances where other laws might limit the creation or the enforcement of a security right in an asset of a certain category of grantors (for example, individuals) and that that aspect would need to be taken into account when conducting due diligence on the asset to be encumbered.

Due diligence on any other credit and security support

75. It was generally felt that the Chapter could include a section explaining that secured creditors, in certain instances, also took other forms of credit support, typically from third parties, for example, in the form of guarantees, letters of credit or credit insurance. It was further suggested that that section could indicate that guarantees were frequently taken from individuals (which might be further secured) to support lending to micro-businesses. In essence, that section would provide guidance to secured creditors that similar level of due diligence should be conducted on those third parties providing credit support.

Documenting the terms of finance

76. Recalling its deliberations that the draft Practice Guide should not deal with lending practices in general (see paras. 23–24 above), the Working Group agreed that the Chapter should not address commercial terms of a finance transaction nor include any sample loan agreements.

77. It was noted that certain terms of the financing agreement (including amount of the loan) could be closely interlinked with the value of the encumbered asset and that the Chapter might touch upon those aspects.

78. During the discussion, a question was raised whether the draft Practice Guide should provide any guidance on events of default. Noting that the definition of "default" in article 2(j) of the Model Law included the possibility of the grantor and the secured creditor agreeing on what could constitute a default under the Model Law, it was generally felt that the Practice Guide could include an illustrative list of typical events of default, which could trigger the enforcement of the security right. In that context, it was suggested that the section dealing with enforcement of a security right could also touch upon the relevant aspects possibly through a cross-reference. It was also suggested that the draft Practice Guide could provide guidance to lenders on possible clauses to be included in the security agreement containing events of default specifically relating to the collateral (for example, a breach by the grantor of its obligation to exercise reasonable care to preserve the asset), recognizing however that the nature of such clauses would be very dependent on the type of asset and transaction involved. At the same time, it was observed that the draft Practice Guide should highlight that the autonomy of the parties to agree to such terms might be limited by other laws in some States (for example, laws protecting consumers or other debtors).

Security agreement

79. The Working Group agreed that the Chapter should include a section explaining how parties could prepare their security agreement. It was widely felt that the Chapter could contain: (i) a general section providing such guidance, which could further elaborate why parties might choose to go beyond the minimal requirements in article 6 of the Model Law and (ii) a few sample security agreements in the annex with annotations, which would deal with different types of transactions. With respect to the latter, preference was expressed for including security agreements in their entirety. It was also stated that those examples could include sample provisions often found within financing agreements that dealt with the security aspect. In that context, the Working Group was informed of the technical difficulties that could arise with regard to the presentation and translation of those sample security agreements or clauses.

Closing the deal

80. It was generally felt that the Chapter should include a section on closing the secured finance transaction, which would normally include registration of a notice, ensuring that the grantor had executed all relevant documents, and the disbursements of funds. In that context, it was mentioned that the draft Practice Guide should, however, not prescribe an order in which such actions were to be taken nor imply that registration of a notice was the only way of making a security right effective against third parties.

81. It was widely felt that the draft Practice Guide should highlight the fact that the Model Law allowed secured creditors to register a notice before the creation of a security right or the conclusion of a security agreement. It was also stated that the draft Practice Guide could mention the importance of a search of the registry after the registration of a notice to ensure that the priority of the security right was retained. In relation, it was stated that draft Practice Guide should also mention the possible need for lenders to search in registries other than the general security rights registry when conducting due diligence of assets to be encumbered (see para. 70 above).

Monitoring collateral

82. The Working Group agreed that the draft Practice Guide should highlight the importance of continual monitoring of collateral after the conclusion of the security agreement, and the disbursement of funds. It was generally felt that the draft Practice Guide could provide some guidance on the topic along with some examples on how the monitoring may differ depending on the transaction or the encumbered asset (for example, intellectual property and agricultural products). In relation, it was stated that the draft Practice Guide should note the desirability of ensuring that monitoring of collateral by the secured creditor would not result in undue interference with the grantor's conduct of business.

83. It was suggested that the draft Practice Guide could provide practical examples on how such monitoring could be performed and also mention the possibility of utilizing third-party service providers for that purpose. It was also mentioned that the draft Practice Guide could explain the need for a lender to consider the eventual cost of monitoring collateral when conducting due diligence of the encumbered asset. In addition, it was also suggested that the section dealing with security agreements (see para. 79 above) could provide guidance to parties that they might wish to include relevant provisions on monitoring in their agreement (for example, scope of and cost related to monitoring).

84. Differing views were expressed on whether the draft Practice Guide should mention the need for the secured creditor to monitor the grantor's ongoing legal and financial status (in addition to the collateral). However, recalling its deliberation to include certain aspects relating to due diligence on customers (see para. 69), it was generally felt that a similar approach should be taken. Particular attention was drawn to micro-businesses, which were more likely to change legal status and because a security right was often created over all their assets.

How to search in the registry

85. It was agreed that the Chapter could include a section explaining how to conduct a search of the registry and how to understand the search results. It was said that the section could include some explanation of the limitations inherent in any search result and further illustrate what steps a searcher could take to obtain additional information. It was also suggested that the section could draw the attention of the users to the conflict-of-laws rules in the Model Law and the potential need to search in registries of other jurisdictions.

How and where to register a notice

86. It was agreed that the draft Practice Guide should provide guidance to registrants on how and where to register a notice to make the security right effective against third parties. It was also said that a section in the Chapter should provide guidance to secured creditors on when and how to terminate or amend their registration (for example, if there were a change of grantor identifier or transfer of the encumbered asset), noting that ongoing monitoring of the grantor and the collateral was important. In that context, it was said that the section would need to reflect the fact that the Model Registry Provisions in the Model Law provided a number of options with regard to the operation of the registry, even though only one of the options would be applicable in any given jurisdiction.

How to enforce a security right

87. It was widely felt that prominence should be given to the section in the Chapter dealing with how a secured creditor could use different enforcement mechanisms in the Model Law. It was also widely felt that there would be merit in providing annotated sample notices that a secured creditor would need to give during the enforcement stage in the annex of the draft Practice Guide.

88. In that context, a number of suggestions were made: (i) that the right of a secured creditor to dispose of an encumbered asset as provided in article 78 of the Model Law should be particularly highlighted; (ii) that the enforcement mechanisms that would apply to different types of collateral (including, all-asset security right) should be illustrated; (iii) that practical problems that might arise during the enforcement phase should be outlined; (iv) that the distribution rule as provided in article 79 of the Model Law could be highlighted in comparison with prior rules; and (v) that the section should explain how the existence of a secondary-market could facilitate out-of-court disposition.

89. In relation to enforcement involving micro-businesses, it was suggested that the section could mention: (i) the difficulties in sending notifications to such businesses due to their frequent change of address and refusal to accept notifications; (ii) possible restrictions in other laws limiting assets that could be enforced; and (iii) the possibility of parties agreeing to use alternative dispute resolution to expedite out-of-court enforcement.

How to collect receivables subject to an outright transfer

90. It was felt that the draft Practice Guide could explain the circumstances that relate to outright transfer of receivables, in particular, that a transferee of receivables under an outright transfer would not be subject to the enforcement rules in the Model Law, as there was no underlying secured obligation. It was felt that the draft Practice Guide could explain how an outright transferee, as well as a secured creditor with a security right in a receivable, could collect payment of the receivable and also include sample templates for relevant notifications and payment instructions.

How to transition prior security rights to the Model Law

91. It was felt that the draft Practice Guide could explain what measures a secured creditor would need to take to preserve the third-party effectiveness and priority of its security right created before the new law implementing the Model Law came into effect. It was suggested that a number of examples should be provided. It was suggested that this section should draw the attention of the users to the operation of the transition provisions in the Model Law and not attempt to delve into the details of the prior law, which would vary depending on the jurisdiction.

D. Regulatory issues (A/CN.9/WG.VI/WP.75, paras. 59–74)

92. The Working Group recalled its earlier discussion on the extent to which the draft Practice Guide would address regulatory issues (see paras. 25–28 above) and reaffirmed its working assumption (see para. 29 above). Considering the sensitivity of the issues, it was also reiterated that the draft Practice Guide should not address policies underlying relevant regulations nor make any recommendation suggesting changes to those regulations.

93. As a general point, it was explained that capital regulations in many jurisdictions did not fully take into account the key features of the Model Law and how its operation could possibly allow regulated financial institutions to meet the requirements in those regulations, including capital adequacy requirements. As such, it was stated that the draft Practice Guide could explain how different capital requirements could be met through the implementation of the Model Law. For example, it was mentioned that the draft Practice Guide could illustrate how the enforcement mechanisms envisaged in the Model Law permitted a security right to be enforced in an efficient manner, thus allowing the encumbered movable asset to be considered as eligible collateral. In addition, it was also suggested that the draft Practice Guide could highlight the importance of secondary markets for possible disposal of encumbered assets. As a general point, it was stressed that the aim of addressing regulatory issues in the draft Practice Guide should be to incentivise regulated financial institutions to extend credit based on the Model Law.

94. During the deliberations, the need for the draft Practice Guide to clarify the meaning and scope of “regulated” financial institutions was mentioned, as not all institutions engaged in secured lending would be subject to the same capital regulations, also noting that that would largely differ depending on the jurisdiction.

95. It was also mentioned that the draft Practice Guide could discuss over-collateralization, which had a particularly negative impact on micro-businesses. In that context, reference was made to the relevant discussions in the UNCITRAL Legislative Guide on Secured Transactions (paras. 68–69 of Chapter II) and the different approaches taken in jurisdictions. It was suggested that the issues relating to over-collateralization might be better placed in the portion of the draft Practice Guide addressing transactional issues, drawing the attention of the users to the possible unintended consequences. It was also suggested that the Secretariat be asked to include relevant discussion on over-collateralization in the portion of the draft Practice Guide addressing regulatory issues, without any decision being taken by the Working Group as to the desirability of retaining that text in that portion. It was clarified that that would be a matter for consideration by the Working Group when the relevant text was available for review.

96. Throughout the discussion, it was repeatedly stated that the Working Group should take a cautious approach in addressing regulatory issues. It was generally felt that at this stage, the draft Practice Guide should focus on how the operation of the Model Law could relate to certain regulatory requirements.

97. After discussion, it was generally felt that the Working Group would address the above-mentioned issues more closely at its next session when it had an opportunity to consider a first draft of the Practice Guide.