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Possible future work on security interests

Note by the Secretariat

Contents

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I. Introduction

1. At its fortieth session in 2007, the Commission decided that, after completion of the *UNCITRAL Legislative Guide on Secured Transactions* (the "*Guide*"), future work should be undertaken with a view to preparing a supplement to the *Guide* dealing with security rights in certain types of securities, taking into account work by other organizations, in particular the International Institute for the Unification of Private Law ("Unidroit").[1]

2. At its fourteenth and fifteenth sessions, Working Group VI (Security Interests) had a preliminary discussion about its future work programme. During those sessions, several suggestions were made, including the following: (a) a supplement to the *Guide* dealing with security rights in securities not covered by the Unidroit Convention on Substantive Rules for Intermediated Securities (Geneva, 2009; the "Unidroit Securities Convention");[2] (b) a legislative guide on registration of security rights in general security rights registries; (c) a model law on secured transactions based on the recommendations of the *Guide*; (d) a contractual guide on secured transactions; and (e) a contractual guide on intellectual property licensing (see A/CN.9/667, para. 141, and A/CN.9/670, paras. 123-126, respectively).

3. At its forty-second session in 2009, the Commission noted with interest the future work topics discussed by the Working Group. At that session, the Commission agreed that, depending on the availability of time, preparatory work could be advanced through a discussion at the sixteenth session of the Working Group. The Commission also agreed that the Secretariat could hold an international colloquium early in 2010 with broad participation of experts from Governments, international organizations and the private sector. It was generally agreed that, on the basis of a note by the Secretariat, the Commission would be in a better position to consider and make a decision on the future work programme of the Working Group at its forty-third session.[3]

4. At its sixteenth and seventeenth sessions, the Working Group engaged in a preliminary discussion of its future work programme (A/CN.9/685, para. 96, and A/CN.9/689, paras. 59-61). At the seventeenth session of the Working Group, some support was expressed for work on regulations on registration of security rights and a model law on secured transactions based on the recommendations of the *Guide*. With regard to a supplement to the *Guide* on security rights in certain types of securities, it was observed that that work would have to be limited to non-intermediated securities in view of the work done by Unidroit and the Hague Conference on intermediated securities (see the Unidroit Securities Convention and the Convention on the Law Applicable to Certain Rights in respect of Securities held with an Intermediary; The Hague, 2006; the "Hague Securities Convention").[4] With respect to intellectual property licensing or a possible international registry on security rights in intellectual property, it was noted that any work on those topics

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[1] *Official Records of the General Assembly, Sixty-second Session, Supplement No. 17* (A/62/17 (Part I)), paras. 147 and 160.

[2] http://www.unidroit.org/english/conventions/2009intermediatedsecurities/main.htm.

[3] Ibid., *Sixty-fourth session, Supplement No. 17* (A/64/17), paras. 313-320.

[4] http://hcch.e-vision.nl/index_en.php?act=conventions.text&cid=72.

would need to be closely coordinated with the World Intellectual Property Organization ("WIPO") (A/CN.9/689, para. 61).

5. In accordance with the decision of the Commission at its forty-second session,[5] an international colloquium on secured transactions was held in Vienna from 1 to 3 March 2010. The purpose of the colloquium was to obtain the views and advice of experts with regard to possible future work in the area of security interests. Approximately 100 experts from governments, international organizations and the private sector participated in this three-day event and the discussions thereof provided a basis for this note by the Secretariat. The papers submitted for the international colloquium are available on the UNCITRAL website and selected articles will be published in the Uniform Law Review in coordination with Unidroit.

II. Possible future work topics

A. Security rights in non-intermediated securities

1. Introduction

(a) General

6. The *Guide* addresses, in a comprehensive way, almost all types of movable asset that are important to modern commercial financing transactions: equipment, inventory, receivables (the *Guide* incorporates the principles of the *United Nations Convention on the Assignment of Receivables* and supplements the Convention; the "*Receivables Convention*"),[6] the right to payment of funds credited to a bank account, the right to receive the proceeds under an independent undertaking, negotiable instruments, negotiable documents and intellectual property rights (see recommendation 2, subpara. (a)). However, as all securities are expressly excluded from the scope of the *Guide* (see recommendation 4, subpara. (c)), the *Guide* fails to address an extremely important type of movable asset. This gap is partially filled by the Unidroit and the Hague Securities Conventions. However, as these Conventions deal only with intermediated securities, the gap remains with respect to non-intermediated securities and thus no guidance is provided to States with respect to security rights in non-intermediated securities. It should be noted that Book IX, Proprietary security in movable assets of the Draft Common Frame of Reference (DCFR) of the Principles, Definitions and Model Rules of European Private Law deals with security rights in all types of movable asset, including securities, whether intermediated or not.

7. As financial market transactions typically involve intermediated securities, this gap may not be serious for a financial markets regime. However, it is an important gap for a commercial financing regime because non-intermediated securities are very important in many commercial financing transactions. In the context of commercial financing transactions, it is quite common for the lender to request, in addition to security rights in various assets of the borrower, a security right in the shares of the borrower or its subsidiaries. These securities are often

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[5] Ibid.

[6] http://www.uncitral.org/uncitral/en/uncitral_texts/payments/2001Convention_receivables.html. United Nations publication Sales No. E.04V.14.

privately held, not held by an intermediary, and not traded on a recognized market. Depending on the law of the State in which a particular company is organized, these shares may be either certificated or dematerialized.

(b) The Unidroit Convention on Substantive Rules for Intermediated Securities

8. It should be noted that the main purpose of the Unidroit Securities Convention is to establish a common legal framework for the holding and disposition of intermediated securities (see the preamble to the Convention). Intermediated securities are securities held with an intermediary; they are often referred to as indirectly-held securities although that term is not used in the Convention). A simple case of intermediated securities is the following: ABC, a publicly traded company, has issued shares; the registered holder of the shares in the books of ABC is CDS; Y, a securities broker, has an account with CDS in which shares of ABC are held. Z, an investor, has a securities account with X in which shares of ABC are held. The rights of the investor with respect to the shares of ABC credited to his account are called "intermediated securities".

9. The Unidroit Securities Convention aims at providing basic legal rules on the acquisition and disposition of intermediated securities, including the acquisition of a security right in them. The provisions of the Convention on security rights deal principally with three issues: (a) effectiveness against third parties; (b) priority; and (c) enforcement. With respect to effectiveness against third parties, the Convention provides that a security right in intermediated securities may become effective against third parties if: (a) the securities are held in an account in the name of the secured creditor (see articles 9 and 11); or (b) the holder of the securities grants the control of the securities to the secured creditor (see article 12). Control is acquired by the secured creditor by way of an agreement between the account holder, the securities intermediary and the secured creditor whereby the latter becomes empowered to block a disposition of the securities by the account holder or to dispose of them without any further consent of the account holder. An entry made in the securities account in favour of a secured creditor may also have the same effect as a control agreement.

10. The rules of the Unidroit Securities Convention on priority may be summarized as follows: (a) a secured creditor who becomes the account holder in respect of intermediated securities ranks ahead of any competing claimant (see articles 11 and 19, para. 2); (b) a secured creditor whose security right has been made effective against third parties by control has priority over any security right made effective against third parties by any other method provided by non-Convention law (for example, by registration; see articles 12 and 19, para. 2); (c) if two persons obtain control of the same intermediated securities, the first in time to obtain control will prevail (article 19, para. 3); (d) if a securities intermediary who holds a security right in a securities account maintained by it subsequently permits another secured creditor to obtain control of the account, the other creditor will rank first (article 19, para. 4).

11. The Unidroit Securities Convention also provides that a security right granted by an intermediary in intermediated securities held with another intermediary prevails over the rights of the account holder of the first intermediary if the security interest has been made effective by control (see article 20). As a secured creditor of an account holder cannot enjoy greater rights than those of the latter, this rule may

affect the secured creditors of an account holder. This is not, however, a priority rule in the strict sense because in the circumstances envisaged by the rule, a secured creditor of the account holder and a secured creditor of the intermediary would not hold a security right in the same intermediated securities.

12. The provisions of the Unidroit Securities Convention on enforcement are optional and are intended to supplement domestic laws. It must also be noted that the Convention recognizes a title transfer agreement for security purposes as a distinct legal institution. Accordingly, such a transfer would not be subject to the legal regime applicable to security interests. Essentially, the provisions of the Convention on enforcement permit the secured creditor, if the debtor is in default, to dispose of the intermediated securities privately without any prior notice or court supervision requirement. In addition, the Convention provides that the commencement of insolvency proceedings against the debtor may not stay the enforcement rights of the secured creditor.

13. The Unidroit Securities Convention leaves certain issues to other law. An example of such an issue is the creation of a security right in intermediated securities. Another example is whether such a security right may become effective against third parties by registration of a notice to a general security rights registry (such a security right is subordinate to a security right made effective under the Convention by a book entry or by control). As a result and in view of the fact that the *Guide* does not deal with security rights in securities, no guidance is provided to States with respect to these matters.

2. Desirability

14. In order to determine the desirability of work on security rights in non-intermediated securities, the Commission may wish to consider: (a) some frequently encountered transactions in which non-intermediated securities are used as security for credit to small or medium-size businesses; and (b) the problems created by the wide divergences in the ways that the various legal systems treat these commercial financing transactions.

(a) Transactions in which non-intermediated securities are used as security for credit

15. Where the borrower's assets include the shares of one or more wholly-owned subsidiaries or where the borrower is a holding company and the shares of its subsidiaries are its only assets, the lender may only be willing to extend credit to the borrower based, in whole or in part, on the value of the subsidiaries by obtaining security rights in the shares of the subsidiaries. The lender's primary source of repayment in the event the borrower defaults in the repayment of the loan would be to seek to sell the subsidiaries as going concerns.

16. Security rights in the shares of a borrower can also be extremely important to a lender even in situations where the lender also holds security rights in the borrower's receivables, inventory and other movable assets. The reason is that, depending on the circumstances at the time of enforcement, the lender might conclude that selling the business as a going concern can result in a greater recovery than if the lender enforced its security rights in the borrower's assets by collecting receivables and selling other assets at an auction. A potential buyer often will be willing to pay more because the business is functioning, or because purchasing the

shares would preserve certain contractual arrangements with third parties or tax benefits. In addition, selling a business as a going concern can be more expeditious and less costly than selling the assets piecemeal.

17. A variation on this theme is where the loan is being made to a corporate group that is engaged in a single business, where the intellectual property is owned by one member of the group and the immovable property by another, and the managerial and support services are in a third member of the group. In this situation, the entire corporate group may function as a single enterprise, even though the assets and employees are spread among the various separate legal entities that comprise the group. The prospect of preserving the going concern value of the entire enterprise in this circumstance can be essential to a lender considering a loan to such an enterprise. In this situation, the lender may very well request a security right in the shares of the parent company or of the subsidiaries.

18. In addition, the lender may wish to obtain a direct security right in certain assets of the borrower, but may be unable to do so for a variety of reasons, including the following: (a) the borrower's assets may include rights from leases, licences, sales contracts or other assets in which the borrower may be contractually prohibited from granting a security right; (b) where the assets are owned by a subsidiary or affiliate of the borrower, applicable corporate governance laws in the relevant State may restrict the ability of a company to grant a security right in its assets to secure a loan made to its parent or affiliate; (c) the applicable secured transactions laws may not recognize security rights in certain of the assets of the borrower, such as various types of intellectual property; (d) where the requested loan is intended to finance the acquisition of the shares of the borrower, "financial assistance" laws in the relevant State may make it unlawful for that borrower to grant a security right in its assets to secure such a loan; (e) the tax laws in the relevant State may impose a substantial economic burden on a company that grants a security right in its assets to secure a loan made by its non-domestic parent or affiliate companies.

19. In each of these situations, even though the lender may be unable to obtain a security right in the assets of a company, it may be able to secure its loan with such assets indirectly by obtaining a security right in the shares of the company. Although a security right in the shares of a company will be subordinate to the claims of other creditors of the company, such a security right nevertheless may have sufficient value to a lender to induce it to extend credit. The lender's decision to extend credit will typically be based, in whole or in part, on its ability to preserve the going concern value of the borrower by means of security rights in directly-held securities. Preserving this going concern value can be important to the borrower and third parties as well. One benefit to the borrower is simply that the availability of this remedy may induce the lender to extend more credit to the borrower than it otherwise would, or to extend credit on better terms. A second benefit is that the greater the amount of the loan that the lender will recover through enforcement of the security right, the less likely it is that there will be a deficiency leading the lender to seek to collect from guarantors, and the greater the likelihood that there may be an excess recovery available to pay other creditors or equity holders. There can be a social benefit as well in that, if the enterprise is sold as a going concern, there is a greater likelihood that jobs will be preserved.

(b) Problems to be addressed by a future supplement to the *Guide*

20. In many States, current law provides a mechanism for obtaining a security right in shares of at least certain types of domestic corporate entities. In other States, the law may not expressly address the matter and courts may have to fill the gap by applying by analogy the general security right law. As is currently the case with security rights in equipment, inventory, receivables and other types of movable asset, these laws vary greatly from State to State. For example, the laws of some States provide minimal formal requirements for the creation of a security right in non-intermediated securities, while in other States there are more elaborate formal requirements, such as a notarial document. In addition, in some States, a security right in non-intermediated securities is automatically effective against third parties at the time when it is created, while in other States, a separate act, such as possession of the certificates in the case of certificated securities or registration of the security agreement or the registration of a notice with respect to the security right, is required. Moreover, the laws of many States differ with respect to the rules for determining the priority of a security right in non-intermediated securities as against competing claimants, such as other secured creditors, buyers, judgement creditors or insolvency administrators. Furthermore, the laws of many States differ with respect to the manner in which a security right in non-intermediated securities may be enforced, with some States requiring the commencement of a judicial proceeding and other States permitting non-judicial enforcement.

21. A supplement to the *Guide* that would set forth clear and concise commentary and recommendations for the creation, third-party effectiveness, priority and enforcement of security rights in non-intermediated securities in an efficient and cost-effective manner would encourage lenders to extend credit in situations where they would otherwise be unwilling to do so or to provide more credit at lower cost. To the extent that such laws followed the principles of a text prepared by the Commission, such laws would be harmonized, a result that should facilitate the provision of credit across national borders and thus promote international trade. As capital markets typically involve intermediated securities, such a supplement would not affect in an appreciable way capital markets and laws applicable to capital markets.

3. Feasibility

22. The Commission may wish to note that it would not be difficult to prepare specific commentary and recommendations of the *Guide* with respect to security rights non-intermediated, non-public securities. The following issues would need to be addressed:

(a) The term “securities”

23. The term “securities” may need to be explained and distinguished from negotiable instruments and receivables (security rights in). In this context, one question that may need to be addressed is whether the term should include interests in business ventures that in some States might not be viewed as traditional securities (such as partnership interests and joint venture interests).

24. Alternatively, reference may be made for the meaning of the term “securities” to other texts, such as, for example, the Unidroit Securities Convention, which

provides that "'securities' means any shares, bonds and other financial instruments or financial assets (other than cash) that are capable of being credited to a securities account and of being acquired and disposed of in accordance with the provisions of this Convention" (see article 1, subpara. (a)).

25. It is also important to distinguish: (a) between certificated or tangible securities and uncertificated, intangible or dematerialized securities; and (b) between intermediated securities (that is, those held in a securities account) and non-intermediated securities (that is, those held directly by their owner). These distinctions are important because different rules may apply to different types of securities.

(b) Scope

26. To avoid any overlap with the Unidroit Securities Convention, intermediated securities covered by this Convention would need to be excluded from the scope of any future work by the Commission on security rights in securities. For the same reason, publicly traded securities may also need to be excluded even though they are directly held.

27. The exclusion may take, for example, the form of recommendation 4, subparagraph (a), of the *Guide*, which provides that the law should not apply to "aircraft, railway rolling stock, space objects and ships, as well as other categories of mobile equipment, in so far as such asset is covered by a national law or an international agreement to which a State enacting legislation based on these recommendations … is a party and the matters covered by this law are addressed in that national law or international agreement".

(c) Creation (effectiveness between the parties)

28. The general rules of the law recommended in the *Guide* might apply to the creation of a security right in non-intermediated securities, whether the securities are certificated or dematerialized (see recommendations 13-22).

(d) Effectiveness against third parties

29. With respect to certificated non-intermediated securities, the general rules of the law recommended in the *Guide* that are analogous to those applicable to security rights in negotiable instruments might apply (see recommendations 32 and 37). As a result, a security right in certificated non-intermediated securities may be made effective against third parties by registration or possession.

30. With respect to dematerialized securities, the rule of the law recommended in the *Guide* that are analogous to those applicable to security rights in rights to payment of funds credited to a bank account might apply (see recommendation 49). As a result, a security right in dematerialized non-intermediated securities may be made effective against third parties by registration or control (the control agreement must be among the issuer, the grantor and the secured creditor).

(e) Priority

31. With respect to certificated securities, in line with the analogy to negotiable instruments, a possessory security right may have priority over a registered or other

security right, or over the right of a buyer or other transferee of the securities (see recommendations 101 and 102).

32. With respect to dematerialized securities, in line with the analogy to rights to payment of funds credited to a bank account, a security right made effective against third parties by control may have priority over a registered or other security right, or the right of buyer or other transferee of the securities (see recommendations 103-105).

(f) Enforcement

33. The general rules of the law recommended in the *Guide* might apply to security rights in non-intermediated securities, whether the securities are certificated or dematerialized.

(g) Applicable law

34. With respect to certificated securities, the conflict-of-laws rule of the law recommended in the *Guide* for tangible assets might apply (the law of the State in which the certificated securities are located will apply; see recommendation 203). For dematerialized securities, the law of the State in which the issuer is located might apply.

(h) Coordination with other law

35. A supplement on security rights in non-intermediated securities would need to be coordinated with other law dealing with the custody and transfer of securities, as well as with security rights in securities. As mentioned above, to avoid any overlap with law dealing with security rights in intermediated securities, such as the Unidroit and the Hague Securities Conventions, security rights in intermediated (and perhaps publicly traded) securities would need to be excluded. In addition, to avoid any overlap with any future work of Unidroit on a commentary and an accession kit to the Unidroit Securities Convention, as well as on capital markets that may address issues left by the Unidroit Securities Convention to national law, a supplement on security rights in non-intermediated securities should avoid touching on those issues.

36. At the same time, however, the commentary and the accession kit to the Convention to be prepared by Unidroit should avoid making recommendations to States on issues left by the Convention to national law that would be inconsistent with the recommendations made in the *Guide*. For example, there is no reason why the general rules of the law recommended in the *Guide* with respect to the creation of a security right in a movable asset should not apply to the creation of a security right in intermediated securities. In addition, there is no reason why the general rules of the law recommended in the *Guide* with respect to the third-party effectiveness of a security right in a movable asset by registration of a notice in the general security rights registry should not apply to a security right in intermediated securities.

37. Moreover, such a supplement may need to address questions pertaining to which law applies to a security right in non-intermediated securities that become intermediated securities. For example, one of the questions that would need to be addressed is the impact of that change on security right made effective against

third parties by registration and in particular whether the third-party effectiveness of the security right should continue for a short period of time. Similarly, a supplement would need to address the question of which law applies to a security right in intermediated securities that become non-intermediated securities.

(i) Form and structure of work

38. While the Commission may wish to leave the form and structure of any future work on non-intermediated securities to the Working Group, it may wish to note that such future work could take the form of a supplement to the *Guide*. As the Supplement on Security Rights in Intellectual Property, this new supplement could include asset-specific commentary and recommendations that would modify the general commentary and recommendations of the *Guide*. The structure of this new supplement could follow the structure of the *Guide*, that is, deal with key objectives, terminology, creation, effectiveness against third parties, the registry system, priority, rights and obligations of the parties, rights and obligations of third-party obligors, enforcement, acquisition financing, applicable law, transition and insolvency.

4. Conclusions

39. The Commission may wish to consider whether to entrust at this time Working Group VI with the task of preparing a text (for example, a supplement to the *Guide*) on security rights in non-intermediated securities. The main objective of this supplement would be to complete the work of the Commission on the *Guide* by filling an important gap in the *Guide* with respect to a type of asset that is more important for commercial financial transactions than for financial market transactions. Such a supplement would not interfere with the Unidroit Securities Convention, as it would deal with matters outside the scope of the Convention or not addressed in the Convention.

40. To the contrary, such a supplement could support the Unidroit Securities Convention by presenting to States a complete and coordinated regime on secured transactions, as is already done in the *Guide* with the Cape Town Convention and its Protocols, the Hague Securities Convention, the intellectual property conventions and the *Receivables Convention* (see recommendation 4 of the *Guide*). The Commission may wish to note that the *Guide* supports, for example, the *Receivables Convention* by incorporating the principles of the *Receivables Convention* and by supplementing the regime of the *Receivables Convention* addressing issues that the *Receivables Convention* left to other law. Thus, States may usefully enact both the recommendations of the *Guide* into national law and adopt the *Receivables Convention*.

41. In addition, such a supplement would not interfere with the work of Unidroit on the commentary and the accession kit to the Unidroit Securities Convention, at least if it did not address at all issues related to intermediated securities. If the supplement were to address these issues, the Commission may wish to instruct the Working Group to address them in a way that would be consistent with both the Unidroit Securities Convention and the *Guide*. Moreover, such a supplement would not interfere with future work of Unidroit on capital markets, as normally non-intermediated securities are not used as security for credit in capital market transactions.

42. Alternatively, the Commission may wish to consider assigning a lower priority to this topic. Such an approach would permit the Commission to complete its work on one of the other topics that may be considered to be of higher priority. It would also allow time for Unidroit to complete its work on the commentary and the accession kit to the Unidroit Securities Convention and to develop further its future work on capital markets. In this regard, the Commission may wish to take into account that Unidroit has already developed the Securities Convention and has a good deal of expertise in securities-related matters. If the Commission were to decide to assign a lower priority to this topic than to other topics, the Commission may wish to request the Secretariat to coordinate with Unidroit to ensure that any recommendations Unidroit may make in these future instruments (the commentary and accession kit to the Convention, as well as any future text on capital markets) with respect to security rights in securities would be consistent, to the maximum extent possible, with the recommendations of the *Guide*.

43. For example, there is no reason why the general rules of the law recommended in the *Guide* with respect to the creation of a security right in a movable asset should not apply to the creation of a security right in intermediated securities. In addition, there is no reason why the general rules of the law recommended in the *Guide* with respect to the third-party effectiveness of a security right in a movable asset by registration of a notice in the general security rights registry should not apply to a security right in intermediated securities. In such a case, a rule may need to be recommended to deal with the priority of a security right in intermediated securities made effective against third parties by a book entry under the Unidroit Securities Convention as against a security right in the same securities made effective against third parties by registration of a notice in a general security rights registry under non-Convention law (such as the law recommended in the *Guide*).

B. Registration of security rights in movable assets

1. Introduction

44. The establishment of a publicly accessible registry system is an essential feature of the law recommended in the *Guide* (see the preamble to the recommendations in chapter III). Registration enables those dealing with assets in a person's possession or control with a transparent and objective source of information about whether those assets may be subject to a security right. Registration in turn gives secured creditors an efficient mechanism for ensuring the third-party effectiveness of their security rights and for establishing their priority against certain competing claimants (see the preamble to the recommendations of chapter IV).

45. Chapter IV of the *Guide* contains commentary and recommendations on the legal and operational aspects of a general security rights registry. However, like any other chapter of the *Guide*, chapter IV does not stand alone. It is intended to be read in conjunction with the other chapters of the *Guide*. This means that, in order to understand the requirements and legal effects of registration, the reader has to refer to chapter III on the effectiveness of a security rights against third parties and chapter V on the priority of a security right. Similarly, to determine the transactional

and territorial scope of the registry, the reader must refer to the various parts of the *Guide* dealing with the concept of a security right and chapter X on conflict of laws.

46. In addition, the *Guide* does not cover the myriad of administrative, operational, technological and infrastructural details that a State enacting a secured transactions law based on the recommendations of the *Guide* would need to consider in order to implement an efficient and cost-effective registry system. In the absence of this kind of guidance, experience shows that States may end up spending excessive amounts of money and time only to end up with a dysfunctional system that is unnecessarily cumbersome and opaque and that is not responsive to the interests of its business and legal clientele. In view of the central role that the registry plays in the overall framework of secured transactions law, the ultimate result is to undermine a State's attempts to institute reform.

47. In recognition of the importance of concrete registry guidelines to the overall success of secured transactions law reform, some organizations that prepared model laws on secured transactions, also prepared principles, guidelines or regulations with respect to the registration of security rights. For example, the European Bank for Reconstruction and Development (EBRD), which prepared the EBRD Model Law on Secured Transactions,[7] also prepared Guiding Principles for the Development of a Charges Registry.[8] Similarly, the Organization of American States (OAS), which prepared the OAS Model Law on Secured Transactions,[9] also prepared Model Registry Regulations under the Model Inter-American Law on Secured Transactions.[10]

48. In addition, other organizations involved in secured transactions law reform developed detailed rules with respect to the registration of security rights. For example, the Asian Development Bank prepared a Guide to Movables Registries.[11] Moreover, organizations or States that introduce modern secured transactions laws make the establishment and the development of a general security rights registry a central part of their law reform effort. For example, the Convention on International Interests in Mobile Equipment (Cape Town, 2001)[12] and the Protocol to the Convention on International Interests in Mobile Equipment on Matters specific to Aircraft Equipment (Cape Town, 2001)[13] contain detailed rules with respect to an international asset-specific registration system that is very similar to the one recommended in the *Guide*. In addition, Book IX of the Draft Common Frame of Reference (DCFR) of the Principles, Definitions and Model Rules of European Private Law[14] contain detailed rules on the registration of security rights that are largely similar to the rules recommended in the *Guide*.

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[7] http://www.ebrd.com/pubs/legal/secured.pdf.

[8] http://www.ebrd.com/country/sector/law/st/core/pledge/core.htm.

[9] http://www.oas.org/dil/cidip-vi-securedtransactions_eng.htm.

[10] http://www.uncitral.org/pdf/english/colloquia/3rdSecTrans/John_Wilson_MR.pdf.

[11] http://www.adb.org/documents/reports/movables_registries/default.asp.

[12] http://www.unidroit.org/english/conventions/mobile-equipment/main.htm.

[13] http://www.unidroit.org/english/conventions/mobile-equipment/main.htm#NR2.

[14] C. v. Bar and E. Clive (ed.), Principles, Definitions and Model Rules of European Private Law. Draft Common Frame of Reference. Vol. 6 (2009) pp. 5389-5667.

2. Desirability

49. As mentioned above, while chapter IV of the *Guide* provides valuable commentary on the registry system contemplated by the *Guide*, for the reader to comprehend the legal relevance of registration it is necessary to have a comprehensive detailed understanding of the *Guide* as a whole. Accordingly, a text on registration that presented the legal aspects of registration in an integrated summary and accessible plain-language manner would greatly assist those involved in the implementation of the registry who may not be secured transactions law experts but who will require a basic knowledge of the overall legal framework in which the registry is designed to operate in order to carry out their work. As also mentioned above, such a text would additionally enable detailed guidance to be given on the full panoply of legal, practical and operational issues that need to be addressed in the course of implementing a registry system but which chapter IV does not now address or does not address in sufficient detail. In view of the central importance of the registry to the overall success of secured transactions legal reform, preparation of a text on registration that would substantially supplement chapter IV of the *Guide* would be desirable.

50. In many States, the most familiar registry model for property rights is the land registry which differs significantly in its purpose and structure from the notice-filing registry model recommended in the *Guide* for security rights in movable assets. Accordingly, in the absence of more specific guidance on the function and structure of the registry, there is a risk that features and procedures of the land registry model will be carried over unnecessarily to the security rights registry system with a resulting loss in the efficiency and effectiveness of the system. For example, such a system involves a major difference in the role of the registry personnel which, rather than acting as gatekeepers as in a land titles system, operate essentially as background administrators to facilitate filing and searching without official interference. In addition, the notice-filing registry model, unlike most land registries, easily allows for the maximum exploitation of the electronic technology, and a registry guide would enable detailed direction to be given at this level.

51. Moreover, even if a State implements a secured transactions law based on the recommendations of the *Guide*, that State will still need to deal with a number of operational and legal issues that are normally not addressed in the secured transactions law but rather in subordinate registration regulations or administrative guidelines. Without guidance at this level, secured transactions law reform cannot be effectively and efficiently implemented. Thus, a text on registration that would include, for example, principles, guidelines and regulations with respect to the registration and searching process would usefully complete the work of the Commission on secured transactions. It could be reasonably expected that, with such a complete secured transactions system, States would find it easier to implement a law based on the recommendations of the *Guide* and do so in a coordinated and coherent manner that would allow them to benefit from the effective implementation of the law. Finally, a text on registration would also provide a valuable resource for the purposes of practical educational programmes and training programmes for registry administrators and personnel, as well as for financiers, businesses, lawyers and other users of the registry system.

3. Feasibility

52. The work achieved so far by the Commission and other organizations mentioned above is a good indication of the likelihood that the Commission could successfully prepare a text on registration of security rights within a reasonable period of time. In determining the feasibility of such a project, the Commission may also wish to take into account the following issues to be addressed in the course of the implementation of such a project.

(a) Purposes of registration

53. A text on registration could discuss the purposes of registration of a notice of a security right in a general security rights registry, drawing on the various chapters of the *Guide*.

(b) Registration forms

54. A text on registration could discuss in some detail the minimum mandatory content and any additional optional content of the notice of the security right that must be registered. In this respect, this text could draw on the commentary of the *Guide* and elaborate further, for example, by including sample registration forms.

(c) The registration and search process

55. A text on registration could discuss issues relating to the registration and search process, including: (a) whether the notice must be submitted in paper or in, electronic form, or whether both should be permitted; (b) whether a searcher would have to submit a search inquiry in paper or electronic form or whether both should be available; (c) the appropriate way to identify the grantor, as the grantor identifier is the principal registration and search criterion; (d) the appropriate way to describe the encumbered asset, in particular to the extent it may be a supplementary registration and search criterion for some types of transaction; and (e) modes of access to the registry for registration and searching. Although the *Guide* already addresses many if not all of these issues, a text on registration could elaborate further with more specific and detailed examples, as well as setting out sample regulations or administrative guidelines.

(d) Effectiveness of registration

56. A text on registration could discuss questions relating to the legal effectiveness of a registration and how these questions relate to the technical design of the registry system, including: (a) whether advance registration should be possible and how it is to be effected; (b) whether a single registration for successive security agreements should be possible and how it is to be effected; (c) the time when registration becomes legally effective taking into account the manner in which registrations are tendered and processed by the system; (d) the legal effect of unauthorized amendments and discharges and administrative and technical procedures for dealing with the consequences and for reinstating the registrations; and (e) what constitutes an adequate description of the encumbered asset and the effect of errors or omissions in registered particulars. Once again, the *Guide* addresses many, if not all, of these issues but a text on registration would provide valuable elaboration.

(e) Registry administration

57. A text on registration could discuss questions relating to the administration and operation of the registry, including: (a) financing the start-up and operational costs of the registry; (b) the potential role of private operators in the administration and operation of the registry; (c) the role of government in creating and supervising the registry; (d) the liability of the registry; (e) the security of the registry record (addressing also concerns about fraudulent or false registrations and discharges as well as the risk of corruption in the operation of the registry); and (f) the appropriate balance to be struck between operational efficiency and the reliability and security of registry data. Again, some of these issues are already addressed in the *Guide*, but a text on registration would provide more detailed guidance as well as covering additional matters.

(f) Transactional scope of the registry

58. A text on registration could address questions relating to the transactional scope of the registry, including: (a) the range of transactions to be covered; (b) the exclusion of possessory pledge types of security devices; (c) the principle of "substance over form" in characterizing security rights; (d) the treatment of acquisition financing devices (for example, retention-of-title sales, financial leases and functional equivalents of these); (e) the treatment of true long-term leases, assignments of receivables, commercial consignments, judgment liens and security rights created by law; and (f) coordination with specialized registries (for example, immovable, ship, aircraft and intellectual property registries. The *Guide* addresses most, if not all, of these issues, but a text on registration may usefully elaborate.

(g) Territorial scope of the registry

59. A text on registration could discuss questions relating to the territorial scope of the registry, including: (a) the context within which conflict-of-laws issues relating to registration may arise; (b) conflict-of-laws issues relating to the registration of security rights in tangible encumbered assets; and (c) conflict-of-laws issues relating to security rights in intangible encumbered assets. Although the *Guide* already addresses most, if not all, of these issues in the context of conflict of laws generally, the text on registration would focus on how these rules apply to registration-related issues, in particular and to the design of the registry.

(h) Additional issues

60. Additional issues that might valuably be addressed in a text on registration include technical issues related to the design and operation of the registry, notably: (a) the computer architecture; (b) staff training; (c) educational and publicity outreach to the registry clientele and public generally; (d) post-implementation data collection and dissemination; and (e) the need to build in research and development capability to be able to respond to new developments.

(i) Form and structure of work

61. While the Commission may wish to leave the form and structure of any future work on registration to the Working Group, the Commission may wish to consider that such work could take the form of a guide on the implementation of a security

rights registry. Such a guide may respond to the need identified above, add value to the *Guide* and, at the same time, be reasonably feasible to prepare. The Commission also may wish to note that such a guide, by building on and integrating the work already done by other international organizations and by States that have implemented a registry along the lines of that contemplated by the *Guide* could result in international minimum standards for registration and search procedures and for registry design, administration, and operation, thereby contributing further to the international harmonization of secured transactions regimes.

62. As to the structure of such a registry guide, it could include commentary accompanied by recommendations or guidelines addressing the sets of issues identified above. This text could be accompanied by a lexicon defining legal and technical terms relevant to the registry, by a checklist setting out the issues and the sequence of steps involved in the implementation of a registry, and by a bibliography listing further resources.

63. Moreover, such a registry guide could include model regulations or administrative rules with accompanying commentary explaining policy choices and consequences. In this context, the Commission may wish to note that a prescribed set of regulations ("one size fits all") may not be sufficient. Alternative regulations may need to be provided to appropriately reflect different modes of implementation of the registry and different policy choices by States in relation to the issues identified above. For example, the regulations would have to take into account for each State the existence of other registries for specific types of encumbered asset (for example, patents) and the relationship of the registry to these other registries. Moreover, while the basic element of registration based on grantor identifier is central to the contemplated registry for all States, the particular grantor identifier or identifiers to be used (for example, names as compared with State issued identification numbers), and the types of asset that might be susceptible to supplementary serial-number registration, might well differ from one State to another.

64. Furthermore, the allocation of legal rules relating to the registry between the secured transactions law and the subordinate regulations or administrative rules may well vary in different States. The difficulties in amending the principal law in some States might point in the direction of placing most if not all legal issues relating to the registry into the regulations which may more easily be adjusted to respond to change. Other states, concerned with the risk of too frequent or otherwise inappropriate changes by those vested with the discretion to amend the rules, might prefer to imbed at least the most important rules in the principal law. Consequently, the regulations will need to be presented in a flexible manner that enables them to be incorporated either as part of the principal law or as administrative guidelines. The presentation will also need to take account of how best to accommodate different legal styles in different legal traditions.

65. While the registration guide and any model regulations that might be developed should reflect the recommendations of the *Guide*, they may not have to be a supplement to the *Guide*. A stand-alone guide on registration could be extremely useful to States that are interested in improving and integrating their existing registries for security rights in movables, even if their substantive laws differ from the law recommended in the *Guide*.

4. Conclusions

66. Experience shows that secured transactions law reform cannot be effectively implemented without the establishment of an efficient publicly accessible security rights registry. It also shows that States are often forced to invest more funds than should be necessary to establish and operate such a registry owing to the absence of clear guidance on the implementation process and the legal and operational framework of the registry. As a general text on secured transactions, the *Guide* does not cover, or does not address in sufficient detail, the myriad of legal, administrative infrastructural and operational questions that must be addressed and resolved to ensure the successful and efficient implementation of a registry.

67. Thus, the Commission may wish to consider entrusting Working Group VI with the task of preparing a text on registration as a matter of priority. Such a text would usefully supplement the Commission's work on secured transactions and provide urgently needed guidance to States with respect to the establishment and operation of a general security rights registry. While the specific form and structure of the text could be left to the Working Group, the Commission may wish to note that: (a) such a text could include principles, guidelines, commentary, recommendations and model regulations; and (b) draw on the work of the Commission on the *Guide*, as well as on the work of other organizations, such as the European Bank on Reconstruction and Development, the Organization of American States and the Asian Development Bank, as well as national law regimes that have implemented registry systems along lines similar to the registry contemplated by the *Guide*.