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## Security Interests

### Draft Legislative Guide on Secured Transactions

#### Security rights in rights to payment of funds credited to bank accounts: definitions and recommendations

##### Note by the Secretariat

##### Addendum

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## **Security rights in rights to payment of funds credited to bank accounts**

### **I. Definitions (A/CN.9/WG.VI/WP.22/Add.1, para. 21 (o), (cc) and (hh))**

(o) “Receivable” means a right to the payment of a monetary obligation, excluding, however, rights to payment evidenced by a negotiable instrument, the obligation to pay under an independent undertaking and the obligation of a bank to pay funds credited in a bank account.

*[Note to the Working Group: The Working Group may wish to note that the encumbered asset is described as “the right to payment of funds credited to a bank account” rather than the bank account itself. Therefore, the definition of “bank account” could be placed in the commentary. The commentary will also include a description of institutions covered under the term “bank”. In this connection, the Working Group may wish to consider whether the term “bank” should cover all institutions that have a banking licence under the law of the enacting State, which may include payment institutions, payment, clearing and settlement systems operating cash accounts and central banks. The Working Group may wish to note that the commentary to a previous version of the recommendations on bank accounts is in document A/CN.9/WG.VI/WP.18 and Add.1.]*

[(cc) “Bank account” means an account maintained by a bank into which funds may be deposited. The term includes checking, saving and time-deposit accounts.]

#### **Definition of “control” (see A/CN.9/WG.VI/WP.24/Add.3, Note to the Working Group after rec. 43)**

(hh) A secured creditor has “control” with respect to funds credited to a bank account: (i) automatically upon the creation of a security right where the depositary bank is the secured creditor; (ii) where the depositary bank has concluded a control agreement with the grantor and the secured creditor, according to which the depositary bank has agreed to follow instructions from the secured creditor with respect to the right to payment of funds credited to the bank account without further consent of the grantor; or (iii) the right to payment of funds credited to a bank account is transferred to secured creditor.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that: (i) there is no obligation on a depositary bank to enter into a control agreement; (ii) that a secured creditor’s rights will be subject to the rights and obligations of the depositary bank under law and practice governing bank accounts; (iii) a control agreement requires the consent of the grantor (as well as of the depositary bank) and the grantor retains the right to deal with the funds in the bank account until the secured creditor instructs the depositary bank otherwise (although in some control agreements, the funds would be blocked from the time of the conclusion of the control agreement).]*

## II. Recommendations

### Scope

#### **Parties, security rights, secured obligations and assets covered (A/CN.9/WG.VI/WP.21, rec. 3 (d))**

3. In particular, the law should provide that it applies to:

(d) All types of movable assets and fixtures, tangible or intangible, present or future, not specifically excluded in the law, including inventory, equipment and other goods, receivables, negotiable instruments (such as cheques, bills of exchange and promissory notes), negotiable documents (such as bills of lading), rights to payment of funds credited to bank accounts, rights to drawing proceeds from independent undertakings, and intellectual property rights;

#### **Creation of a security right in a right to payment of funds credited to a bank account (see A/CN.9/WG.VI/WP.21, rec. 26)**

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendation 8 (see A/CN.9/WG.VI/WP.21), a security right in a right to payment of funds credited to a bank account may be created by agreement between the grantor and the secured creditor.]*

26. The law should provide that a security right in a right to payment of funds credited to a bank account is effective as between the secured creditor and the grantor notwithstanding an agreement between the grantor and the depositary bank limiting in any way the grantor's right to create a security right in its right to payment of funds credited to the bank account. However, the depositary bank has no duty to recognize the secured creditor and no obligation is otherwise imposed on the depositary bank with respect to the security right, without the depositary bank's consent.

*[Note to the Working Group: The Working Group may wish to note that the commentary to recommendation 3 (a) (see A/CN.9/WG.VI/WP.21) will clarify that enacting States may wish to take into account any impact that the recommendations in this Guide might have on consumer protection law.]*

#### **Rights and obligations of the depositary bank (see A/CN.9/WG.VI/WP.24/ Add.3, Note to the Working Group after rec. 43)**

X. The law should provide that:

(a) The creation of a security right in a right to payment of funds credited to a bank account does not affect the rights and obligations of the depositary bank without its consent; and

(b) The rights of set-off of the depositary bank [are not impaired by reason of] [are distinct from] any security rights that the depositary bank may have in a right to payment of funds credited to a bank account.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendations X and Y are supplemented by recommendations 76, 77 (to the extent that there is a priority conflict between a security right or right of set-off of the depositary bank and a security right of another person) and 106 bis, 107 and 108 (enforcement against the depositary bank).*

*The commentary will also explain that recommendation X (b) does not deal with a priority conflict but with the situation where the depositary bank itself has both a right of set-off against and a security right in a right to payment of funds credited to a bank account. In this situation, according to recommendation X (b), the bank's rights of set-off are not impaired or subsumed (i.e. they remain distinct from) the bank's security right.]*

Y. The law should provide that nothing in these recommendations obligates a depositary bank to:

(a) Pay any person other than a person that has control with respect to funds credited to a bank account; or

(b) Respond to requests for information about whether a control agreement or a security right in its own favour exists and whether the grantor retained the right to dispose of the funds credited in the account.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that recommendation Y does not affect the bank-customer relationship and the rights and obligations arising from other law governing bank accounts (e.g. money-laundering, bank secrecy).]*

**Third-party effectiveness of a security right in a right to payment of funds credited to a bank account (see A/CN.9/WG.VI/WP.24/Add.3, recs. 42 and 43)**

43. The law should provide that a security right in a right to payment of funds credited to a bank account is effective against third parties also if the secured creditor obtains control with respect to the funds credited to the bank account.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that, pursuant to recommendation 35 (see A/CN.9/WG.VI/WP.24/Add.3), a security right in a right to payment of funds credited to a bank account may also become effective against third parties by registration of a notice in the general security rights registry.]*

**Priority of a security right in a right to payment of funds credited to a bank account (see A/CN.9/WG.VI/WP.24/Add.4, recs. 76-78)**

76. The law should provide that a security right in a right to payment of funds credited to a bank account, which has been made effective against third parties by control, has priority over a security right in a right to payment of the funds, which has been made effective against third parties by any other method. If the secured creditor is the depositary bank, the depositary bank's security right has priority over any other security right (including a security right made effective against third parties by a control agreement with the depositary bank even if the depositary bank's security right is later in time).

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that a security right of the depositary bank has always priority even over a security right with respect to which the bank has earlier entered into a control agreement because: (i) a security right of the depositary bank should have the same priority as its set-off right, which has always priority; (ii) if the depositary bank's security right had no priority, the bank would not enter into any control agreement; (iii) a secured creditor could always seek to obtain a subordination agreement from the depositary bank.]*

77. The law should provide that any right of the depositary bank to set-off against the right to payment of funds credited to a bank account obligations owed to the depositary bank by the grantor has priority over the security right of any secured creditor other than a secured creditor who has acquired control with respect to the funds credited to the bank account by becoming a transferee of the right to payment of the funds.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that these priority recommendations mean that third parties are taken to know that they cannot rely on a right to payment of funds credited to a bank account as a primary source of security for extensions of credit and can do so only by obtaining a subordination agreement from the depositary bank or having the account entered in their own name. Consequently, the absence of publicity of the security right is not seen as problematic.]*

*The commentary will also explain that, unlike recommendation X (b), recommendation 77 deals with priority conflicts between rights of set-off of the depositary bank and security rights of other persons. Moreover, the commentary will explain that recommendation 77 does not create any rights of set-off, a matter which remains subject to other law.]*

78. In the case of a transfer of the right to payment of funds from a bank account initiated by the grantor, the law should provide that the transferee of the right to payment of the funds takes free of a security right in the right to payment of funds credited to the bank account, unless the transferee acts in collusion with the grantor to deprive the secured creditor of its security right in the right to payment of the funds. This recommendation does not lessen the rights of transferees of rights to payment of funds from bank accounts under law other than this law.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that the general priority recommendations apply to security rights in rights to payment of funds credited to a bank accounts subject to recommendations 76 to 78.]*

**Enforcement of a security right in a right to payment of funds credited to a bank account (see A/CN.9/WG.VI/WP.24/Add.1, recs. 106 bis, 107 and 108)**

106 bis. The law should provide that after default or before default with the consent of the grantor a secured creditor with a security right in a right to payment of funds credited to a bank account may, subject to recommendations X and Y, collect or otherwise enforce its right to payment of the funds.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that the reference to recommendations X and Y is designed to complement recommendations 76 and 77.]*

107. The law should provide that after default or before default with the consent of the grantor, a secured creditor that has control with respect to funds credited to a bank account is entitled to enforce its security right without having to resort to a court or other authority.

*[Note to the Working Group: The Working Group may wish to note that the commentary will explain that, unlike a secured creditor that has to collect the funds to apply them to the secured obligation according to recommendation 116 (see A/CN.9/WG.VI/WP.24/Add.1), a depositary bank as a secured creditor may apply the funds to the secured obligation directly. The commentary will also explain that enforcement of the bank's rights of set-off remains subject to other law.]*

108. The law should provide that a secured creditor that does not have control with respect to funds credited to a bank account may collect or otherwise enforce the security right against the depositary bank only pursuant to a court order, unless the depositary bank agrees otherwise.

**Law applicable to a security right in a right to payment of funds credited to a bank account (A/CN.9/WG.VI/WP.24, rec. 139)**

139. Except as otherwise provided in recommendation 140, the law should provide that the creation, the effectiveness against third parties, the priority over the rights of competing claimants, the rights and duties of the depositary bank with respect to the security right and the enforcement of the security right in a right to payment of funds credited to a bank account are governed by

**Alternative A**

the law of the State expressly stated in the account agreement as the State whose law governs the account agreement or, if the account agreement expressly provides that another law is applicable to all such issues, that other law. However, the law of the State determined pursuant to the preceding sentence applies only if the depositary bank has, at the time of the conclusion of the account agreement, an office in that State which is engaged in the regular activity of maintaining bank accounts. The law should also specify that, if the applicable law is not determined pursuant to the preceding two sentences, the applicable law is to be determined pursuant to fallback rules based on article 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary.

*[Note to the Working Group: Alternative A is an abbreviated version of the approach followed in articles 4.1 and 5 of the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held With An Intermediary ("the Hague Securities Convention"). The commentary will include the detailed fallback rules in article 5 of the Hague Securities Convention with sufficient explanation.]*

**Alternative B**

the law of the State in which the bank that maintains the bank account has its place of business. In the case of more than one place of business, reference should be made to the place where the branch maintaining the account is located.

*[Note to the Working Group: The Working Group may wish to consider whether alternative B should address methods for identifying the branch which maintains an account.]*

*The Working Group may also wish to note that the commentary will explain that the recommendations on the impact of insolvency on the law applicable, as well as the other general recommendations in the conflict-of-laws chapter (A/CN.9/WG.VI/WP.24), apply to security rights in rights to payment of funds credited to bank accounts.]*