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

Note by the Secretariat

Addendum

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2. Secured creditor information

1. The *Secured Transactions Guide* recommends that the identifier of the secured creditor or the secured creditor's representative, along with its address, be included in the notice submitted to the registry (see *Secured Transactions Guide*, rec. 57, subpara. (a)). The regulation should restate and, where necessary, supplement this recommendation (see draft Registry Guide, rec. 27).

2. The regulation should specify that the same identifier rules that apply to the grantor should apply also to the secured creditor or its representative. In this connection, it should be noted that an agent or trustee of a syndicate of lenders would be a representative of the secured creditor if the security right is granted to the syndicate of lenders, but a "secured creditor" if the security right is "granted" (even nominally) to the agent. A third-party service provider, who may submit a notice on behalf of the secured creditor, is neither the secured creditor nor its representative in the sense of the *Secured Transactions Guide*, unless the service provider's name is inserted in the secured creditor field in the registered notice.

3. The identifier of the secured creditor or its representative is not an indexing or search criterion (see A/CN.9/WG.VI/WP.54/Add.2, paras. 21-23, and A/CN.9/WG.VI/WP.54/Add.4, paras. 42-45). Accordingly, the consequences of an incorrect or insufficient statement of the secured creditor identifier are different from those of an incorrect or insufficient statement of the grantor identifier (see paras. 20-24 below); and, even if the regulation requires additional identifier information to be entered in order to uniquely identify the grantor (for example, birth date or a personal identification number), there is no need to extend this requirement to the secured creditor.

4. The secured creditor identifier that should be entered in the notice may be either that of the actual secured creditor or that of its representative. This approach is intended to facilitate, for example, syndicated lending, since only the identifier of the trustee or agent for the syndicate of lenders need be entered in a notice. It is also intended to protect the privacy of the secured creditor. The rights of the grantor are not affected since the grantor is in a direct relationship with the secured creditor and already knows the secured creditor's identity. The rights of third parties also are not affected as long as the representative identified in the notice as the secured creditor is in fact authorized to act on behalf of the actual secured creditor in any communication or dispute connected to the security right to which the notice relates.

3. Description of encumbered assets

(a) General

5. The *Secured Transactions Guide* recommends that a description of the encumbered assets covered by the security right to which the registration relates should be a required component of an effective notice (see *Secured Transactions Guide*, rec. 57, subpara. (b)). This approach enables third parties dealing with a person's assets (such as prospective secured creditors, buyers, judgement creditors and the insolvency representative of that person) to determine which assets of that

person may be encumbered by a security right and which assets may not be encumbered. The *Secured Transactions Guide* also recommends that a description of the encumbered assets should be considered sufficient, for the purposes of both an effective security agreement and an effective registration, as long as it reasonably allows identification of the encumbered assets (see *Secured Transactions Guide*, recs. 14, subpara. (d), and 63). Depending on the nature of the encumbered asset, the description may be specific or generic. For example, if the encumbered asset is one of many paintings owned by the grantor, the description in the notice may specify the title of the painting and the name of the painter in order to sufficiently identify the painting which is intended to be encumbered. On the other hand, if the encumbered assets are generic categories of assets, such as all the inventory of an art gallery, it would be sufficient to describe them generically, for example, as "all of the grantor's paintings", "all of the grantor's works of art" or "all of the grantor's inventory".

6. The regulation should restate and, where necessary, supplement this recommendation (see the draft Registry Guide, rec. 28). In particular, the regulation should explicitly state that the description of encumbered assets in a notice may be specific or generic as long as it reasonably allows their identification. The regulation should also clarify that a description that refers to all assets within a generic category or to all assets of a grantor is assumed to cover future assets within the specified category to which the grantor acquires rights during the duration of effectiveness of the notice.

7. If the prescribed form of notice limits the number of characters that may be entered in the space for describing the encumbered assets and additional space is needed (for example, to identify the encumbered assets in more detail), the registry form should be designed to allow additional information to be provided in an attachment or schedule to the notice. This is generally necessary only where the notice is in paper as opposed to electronic form, since the provision of sufficient space does not pose a practical problem in the latter case.

(b) Description of "serial number" assets

8. As already mentioned (see A/CN.9/WG.VI/WP./Add.2, paras. 24-27), the secured transactions laws of some States adopt supplementary asset-based indexing and searching for specified classes of high-value assets that have a significant resale market. In legal systems that adopt this approach, entry of the serial number in its own designated field is required in the sense of being necessary to achieve third-party effectiveness and priority as against specified classes of third parties that acquire rights in the asset.

9. The *Secured Transactions Guide* discusses but does not recommend this approach (see *Secured Transactions Guide*, chap. IV, paras. 34-36). Nonetheless, even in systems that do not adopt this approach, if the encumbered assets have a serial number, a registrant may wish to include the serial number in the description it enters in the notice as an economical method of sufficiently identifying the encumbered asset in a manner that reasonably allows their identification (see *Secured Transactions Guide*, recs. 63 and 14, subpara. (d)). For that purpose, the notice form could be designed to allow a registrant to enter the serial number in the form, if the registrant so wishes. However, it should be made clear that entry of the serial number is optional and not a mandatory component of an effective

description as long as the description that is entered otherwise sufficiently identifies the asset. In addition, the serial number should not be a legally effective search criterion. Consequently, even if the registry is designed to permit serial number indexing and searching, such a search should be optional and thus a negative search result could not be relied upon.

(c) Description of proceeds

10. The *Secured Transactions Guide* recommends that a security right should automatically extend to any identifiable assets received in respect of the encumbered assets, unless otherwise agreed by the parties to the security agreement (see *Secured Transactions Guide*, Introduction, sect. B, "proceeds", and rec. 19). Where the security right in the original encumbered assets was made effective against third parties by registration, the question arises as to whether the secured creditor needs to amend the description of the encumbered assets in the initial notice to include a description of the proceeds in order to ensure that its security right in the proceeds also is effective against third parties.

11. When the proceeds consist of cash or other equivalent proceeds (for example, money or a right to payment), the *Secured Transactions Guide* recommends the automatic continuation of the third-party effectiveness of a prior registered security right in the original encumbered assets into the proceeds. The same is true where the proceeds are of a type that is already covered by the description of the original encumbered assets in the registered notice (for example, the description covers "all tangible assets" and the grantor trades in one item of equipment for another; see *Secured Transactions Guide*, rec. 39).

12. However, where the proceeds are not cash or other equivalent proceeds and are not otherwise encompassed by the description of the encumbered assets in the existing notice, the secured creditor must amend its registration to add a description of the proceeds within a short period of time after the proceeds arise in order to preserve the third-party effectiveness and priority of its security right in the proceeds from the date of the initial registration (see *Secured Transactions Guide*, rec. 40). An amendment is necessary because a third party otherwise would not be able to identify which categories of asset in the grantor's possession constitute the relevant proceeds.

(d) Description of encumbered attachments to immovable property

13. As already discussed (see A/CN.9/WG.VI/WP.54/Add.1, paras. 21-23), like any other type of encumbered asset, a tangible asset that is or will become an attachment to immovable property needs to be described in a notice registered in the general security rights registry in a manner that reasonably allows its identification (see *Secured Transactions Guide*, recs. 14, subpara. (d), and 63). While a generic description of the asset may be sufficient for this purpose, the registrant may also need to register in the immovable property registry in order to ensure that its security right is effective against third parties that acquire and register a right in the relevant immovable property. In an immovable property registry, registrations are normally indexed or otherwise organized by reference to the specific immovable property as opposed to the identifier of the grantor. Thus, if the notice is to be capable of also being registered in the immovable property registry, the description of the asset in the notice must describe the specific immovable property. In addition,

the rules governing registrations in the immovable property registry may need to be revised to permit the registration of notices and the generic description of encumbered assets (see *Secured Transactions Guide*, chap. III, para. 104). Moreover, if the grantor of the security right in the asset is not the owner of the related immovable property, the notice may also need to identify the owner of the asset if this information is necessary for the indexing of the notice in the immovable property registry.

4. Period of effectiveness of the registration of a notice

14. As already discussed (A/CN.9/WG.VI.WP.54/Add.2 paras. 7-15), the secured transactions law of an enacting State may adopt a uniform statutory period of effectiveness for all registrations (option A) or may give registrants the option to self-select the period of effectiveness (option B). In States that adopt this second option, the regulation should specify that an indication of the duration of effectiveness of a registration in the designated field is a mandatory component of the information that must be entered in a registered notice (see *Secured Transactions Guide*, rec. 69, and draft Registry Guide, recs. 13 and 23, subpara. (a)(iv)). If the enacting State imposes a maximum limit on the registrant's right to self-select the period of effectiveness of the notice (option C), the registry should be designed so as to prevent a registrant from entering a period that exceeds the maximum limit.

5. Maximum amount for which the security right may be enforced

15. The *Secured Transactions Guide* recognizes that some States may require the maximum monetary amount for which the security right may be enforced to be specified in the security agreement and the registered notice (see *Secured Transactions Guide*, chap. IV, paras. 92-97, and recs. rec. 14, subpara. (d), and 57, subpara. (d)). The *Secured Transactions Guide*, however, does not leave room for this requirement to be used as a pretext to impose a tax on secured transactions. The registry fees, if any, should be set at a level no higher than necessary to permit cost recovery (see *Secured Transactions Guide*, rec. 54, subpara. (i), and draft Registry Guide, rec. 36).

16. The aim of this approach is illustrated by the following example. An enterprise has an asset with an estimated market value of $100,000. The enterprise applies for a line of credit facility to a maximum amount of $50,000 (including capital, interest and costs). The creditor is willing to extend the loan on the condition that it obtains a security right in the asset. The grantor is agreeable but since the maximum loan amount specified in the security agreement and in the notice is $50,000 and the asset has a value of $100,000, the grantor wishes to preserve the ability to obtain another secured loan from a subsequent creditor relying on the residual value of the asset. Ordinarily, the first-to-register priority rule may deter this subsequent creditor from giving a loan for fear that the first secured creditor may later extend loans beyond the initial $50,000 for which it would have priority under the general first-to-register rule. By imposing a requirement to specify the maximum value for which the security right may be enforced, the subsequent creditor can be assured that the first-registered secured creditor cannot enforce its security right for an amount greater than $50,000, leaving the residual value available to satisfy its own claim should the grantor default.

17. The *Secured Transactions Guide* recognizes that an equally valid approach is to not require the maximum amount to be included in the security agreement and the registered notice. This approach is based on the assumptions that: (a) the first-registered secured creditor is either the optimal long-term financing source or will be more likely to extend financing, especially to small, start-up businesses, if it knows that it will retain its priority with respect to any financing it may provide to the grantor in the future; (b) in any event, the grantor will not have sufficient bargaining power to require the first-registered secured creditor to enter a realistic maximum amount in the notice (instead the secured creditor will insist that an inflated amount be included to cover all possible future extensions of credit and the grantor will not usually be in a position to refuse); and (c) a subsequent creditor to whom the grantor applies for financing may be able to negotiate a subordination agreement with the first-registered security creditor for credit extended on the basis of the current amount of residual value in the encumbered asset.

18. Thus, the *Secured Transactions Guide* acknowledges that both approaches have merit and recommends that the secured transactions law of an enacting State should adopt the policy that is most consistent with efficient financing and credit market practices in that State. In States that adopt the first approach, the regulation would need to include a rule requiring the registrant to enter the maximum amount and the relevant currency in the designated field in the registered notice (see draft Registry Guide, rec. 23, subpara. (a)(v); for the consequences of entering a different maximum amount in the registered notice than the maximum amount actually agreed to in the security agreement, see paras. 32-35 below). In States that adopt the second approach, there is no need to address the issue further in the regulation.

19. It should be emphasized that in States that adopt the first approach, the *Secured Transactions Guide* does not leave room for an enacting State to base its registration fees on an ascending scale linked to the maximum amount set out in the notice. Registry fees must be set at a level no higher than necessary to permit cost recovery (see *Secured Transactions Guide*, rec. 54, subpara. (i), and draft Registry Guide, rec. 36).

6. Effect of errors or omissions on the effectiveness of the registration of a notice

(a) Grantor information

20. The *Secured Transactions Guide* recommends that registration of a notice is effective only if the notice would be retrieved by a searcher of the registry record using the correct identifier of the grantor (see *Secured Transactions Guide*, chap. IV, paras. 66-77, and rec. 58). The regulation should restate this recommendation (see draft Registry Guide, rec. 29, subpara. (a)). Subject to the last sentence of this recommendation, it follows that an error in the grantor's identifier submitted by the registrant will render the registration of a notice ineffective, with the result that the third-party effectiveness of the security right would not be achieved. It does not matter that the error may seem minor or trivial in the abstract. The sole test is whether the error would cause the information in the registry record not to be retrieved by a searcher using the grantor's correct identifier as the search criterion.

21. The test is an objective one in the sense that the registration will be ineffective to achieve third-party effectiveness even if a competing claimant that challenges the effectiveness of the registration: (a) knew that a security right existed and the

notice that related to it contained errors; and (b) did not suffer any personal prejudice as a result of the notice not being retrievable (for example, where the third-party searcher is the grantor's insolvency representative).

22. The *Secured Transactions Guide* does not include a recommendation as to the impact on the effectiveness of a registration of an error in the address of the grantor or in any additional grantor information (for example, the grantor's birth date or identification number) that the enacting State permits or requires to be included in order to more uniquely identify the grantor (for the discussion on additional grantor information, see A/CN.9/WG.VI/WP.54/Add.2, paras. 59-61 and 69-71). Like the identifier and address of the secured creditor, this type of information does not constitute a search criterion. Accordingly, by analogy to the test recommended in the *Secured Transactions Guide* for errors in the entry of secured creditor information (see *Secured Transactions Guide*, rec. 64), the regulation should specify that an error in the grantor's address or any required additional grantor information does not render the registration of a notice ineffective unless it would seriously mislead a reasonable searcher (see draft Registry Guide, rec. 29, subpara. (b)). For example, if the search result discloses numerous grantors, all having the same name as the person in whom the searcher is interested, but the error in the grantor's address or in any required additional grantor information is so acute as to cause a reasonable searcher to believe that none of the notices refer to the relevant grantor, the registration would be found to be ineffective.

23. The *Secured Transactions Guide* does not deal explicitly with the situation where a notice lists more than one grantor but an error occurs in the identifier of only one of the grantors listed in the notice. In this case, by analogy to the recommendation of the *Secured Transactions Guide* with respect to an error in the description of only some of the encumbered assets (see *Secured Transactions Guide*, rec. 65), the regulation should provide that the error does not render the registered notice ineffective with respect to the other grantors that were sufficiently identified (see draft Registry Guide, rec. 29, subpara. (c)).

(b) Secured creditor information

24. As the identifier of the secured creditor is not an indexing or search criterion (A/CN.9/WG.VI/WP.54/Add.2, para. 22), the *Secured Transactions Guide* recommends that an error by the registrant in the identifier or address of the secured creditor or its representative renders the registration ineffective only if it would seriously mislead a reasonable searcher (see *Secured Transactions Guide*, rec. 64). For example, if the actual secured creditor is Bank A, and a search of the registry record according to the identifier of the grantor returns a result that names Bank B as the secured creditor, the registered notice would generally still be effective, since a search result would still disclose the potential existence of a security right given by the named grantor. However, searchers rely on the identifier and address information of the secured creditor in the registry record for the purposes of sending notices under the secured transactions law. Consequently, a secured creditor may find itself disadvantaged if the secured creditor information that it entered is inaccurate. For example, the *Secured Transactions Guide* recommends that a notice of an extrajudicial disposition of an encumbered asset must be sent to all other secured creditors that have registered notices relating to the same grantor and the same encumbered assets (see *Secured Transactions Guide*, recs. 149-151). A secured

creditor whose information is inaccurate risks not receiving the notice of extrajudicial disposition. In addition, the person named in the registered notice as grantor needs to be able to rely on this information to submit a written request to the secured creditor for the cancellation or the amendment of the notice where the registration was not authorized by the grantor (*Secured Transactions Guide*, rec. 72, subpara. (a), and A/CN.9/WG.VI/WP.54/Add.4, paras. […]).

(c) Description of encumbered assets

(i) General

25. Under the *Secured Transactions Guide*, if a registrant fails altogether to describe an encumbered asset in a registered notice, the third-party effectiveness of the security right in the omitted asset will not be achieved (see *Secured Transactions Guide*, rec. 63). Where the description is merely erroneous, the error renders the registration of the notice ineffective only if the error would seriously mislead a reasonable searcher (see *Secured Transactions Guide*, rec. 64). Even if encumbered assets are omitted or the description is seriously misleading, the registration is ineffective only with respect to the omitted or erroneously described assets and not with respect to other assets that were sufficiently described (see *Secured Transactions Guide*, rec. 65). The regulation should include provisions corresponding to these recommendations (see draft Registry Guide, rec. 29, subparas. (b) and (c)).

(ii) Serial number assets

26. As already mentioned (see para. 8 above), encumbered assets that have a serial number asset may at the discretion of the registrant be described in a notice by reference to the serial number and the type of asset to allow them to be sufficiently identified (see *Secured Transactions Guide*, recs. 63 and 14, subpara. (d)). An error in the serial number or type of asset should be treated in the same way as any other error in the description. Accordingly, a minor error should not render the registration ineffective unless the error would seriously mislead a reasonable searcher (see *Secured Transactions Guide*, rec. 64 and draft Registry Guide, rec. 29, subpara. (b)).

27. Also as already mentioned (see para. 7 above), in some States, the serial number of specified types of asset is required to be entered in a notice in the sense of being necessary to achieve third-party effectiveness and priority as against specified classes of third parties that acquire rights in the asset. In States that adopt this approach, a notice that contained an incorrect serial number would only be effective if it could be retrieved by a search of the registry record under the correct serial number (see *Secured Transactions Guide*, rec. 58). In these States, the regulation will also need to address the consequences of an error in the entry of one but not both the grantor identifier and the serial number. The regulation should provide that both would need to be entered correctly.

(iii) Period of effectiveness of registration

28. As already discussed (see para. 14 above), the secured transactions law of an enacting State may allow a registrant to self-select the period of effectiveness of the registration (see options B and C discussed in A/CN.9/WG.VI/WP.54/Add.2, paras. 9-15). If an enacting State adopts this approach, the *Secured Transactions Guide* recommends that an incorrect statement in the registered notice as to the

period of effectiveness should not render the registration ineffective except to the extent it seriously misled third parties that relied on the registered notice (see *Secured Transactions Guide*, rec. 66). The regulation should include a corresponding recommendation (see draft Registry Guide, rec. 29, subpara. (e)).

29. In addressing how third-party reliance may arise with respect to an error in entering the period of effectiveness of a registration, it is necessary to distinguish two situations (see *Secured Transactions Guide*, chap. IV, paras. 89-91). The first situation is where the error consists in entering too long a period. In this case, third-party searchers would not be prejudiced as they still would have been alerted to the fact that a security right might exist. The second situation is where the error consists in entering too short a period. In this case, the registration will lapse at the end of the specified period and the security right will no longer be effective against third parties, unless it was made effective prior to the lapse by some other method (see *Secured Transactions Guide*, rec. 46). As already mentioned, while the secured creditor can re-establish third-party effectiveness by registering a new notice, its security right will take effect against third parties only from the time of the new registration becoming effective (see *Secured Transactions Guide*, recs. 47 and 96).

30. Similarly, in determining what sort of error in the statement of the maximum amount is likely to cause detrimental reliance by third parties, two situations should be distinguished (see *Secured Transactions Guide*, chap. IV, paras. 96 and 97). Where the registrant enters in the registered notice by mistake an amount higher than the amount specified in the security agreement, third parties are unlikely to be prejudiced since their decision to advance funds to the grantor normally will be based on the amount specified in the registered notice; and the grantor would be entitled to compel the secured creditor to amend the registered notice to reflect the amount specified in the security agreement. In the contrary case where the maximum amount specified in the notice is lower than the amount indicated in the security agreement, a third-party financier that searched the public registry record and extended credit to the grantor in reliance on the record could be prejudiced. Accordingly, if there are competing claimants, the secured creditor should be able to enforce its security right only up to the amount specified in the registered notice. If there are no competing claimants (in other words, there is no third-party reliance and prejudice), the secured creditor should be able to enforce its security right up to the amount specified in the security agreement.

31. It should be noted that (unlike situations covered by rec. 29, subpara. (b), where the test has to be objective; see para. 21 above), in this instance, the test whether the error is seriously misleading is subjective. A third party that challenges the notice on the basis of the error will need to show that it was actually seriously misled by the error. A subjective test is appropriate here since the purpose of requiring the maximum amount to be inserted is to ensure that the grantor can seek additional financing on the basis of the residual value of assets already encumbered by a security right without the third-party financier having to worry about the value of its security right (see *Secured Transactions Guide*, chap. IV, para. 96).

(iv) Maximum monetary amount and impact of error

32. For States that elect to require the maximum amount for which the security right may be enforced to be entered in the notice, the *Secured Transactions Guide* recommends that an incorrect statement in the registered notice of the maximum

amount should not render the notice ineffective except to the extent it seriously misled third parties that relied on the registered notice (see *Secured Transactions Guide*, rec. 66). The regulation should include a corresponding recommendation (see draft Registry Guide, rec. 27, subpara. (e)).

33. As in the case of an error in the entry of the period of effectiveness of a registration (see para. 31 above), the test for whether the error is seriously misleading is subjective. A third party that challenges the notice on the basis of the error must show that it was actually seriously misled by the error. A subjective test is appropriate here since the purpose of requiring the maximum amount to be inserted is to ensure that the grantor can seek additional financing on the basis of the residual value of assets already encumbered by a security right without the third-party financier having to worry about a loss of priority to the first secured creditor (see *Secured Transactions Guide*, chap. IV, para. 96).

34. Thus, where the maximum amount indicated in the notice is greater than the maximum amount agreed to in the security agreement, a subsequent secured creditor generally would not be prejudiced since its decision to advance funds normally will be based on the amount indicated in the notice. The grantor would also be protected in this situation since it could request the secured creditor or, if the secured creditor failed to act in a timely manner, a judicial or administrative body through a summary proceeding, to amend the notice to correct the amount so that the grantor can obtain financing against the residual value of the encumbered asset (see *Secured Transactions Guide*, rec. 72).

35. However, where the maximum amount indicated in the notice is less than the maximum amount agreed to in the security agreement, a subsequent secured creditor may have advanced credit on the assumption that it could enforce its security right against any residual value in the asset in excess of the amount indicated in the notice. Similarly, a buyer may have purchased the encumbered asset on the understanding that the secured creditor's right in it was limited to the value indicated in the notice. In addition, a judgement creditor may have initiated enforcement action in the belief that the excess value of the asset above that stated in the notice would be available to satisfy its judgement claim. Accordingly, the secured creditor in all these cases should be entitled to enforce its security right as against the third party only up to the maximum amount erroneously stated in the registered notice. It should be noted that the secured creditor can never, in any event, enforce its security right for an amount greater than that which is actually owed to it.

B. Recommendations 23-29

[*Note to the Working Group: The Working Group may wish to consider recommendations 23-29, as reproduced in document A/CN.9/WG.VI/WP.54/Add.5. The Working Group may also wish to note that, for reasons of economy, the recommendations are not inserted in here at this stage but will be inserted in the final text*.]