



**United Nations Commission on  
International Trade Law**  
**Fifty-second session**  
 Vienna, 8–19 July 2019

## **Draft Practice Guide to the UNCITRAL Model Law on Secured Transactions**

**Note by the Secretariat**

### Contents

	<i>Page</i>
I. Introduction . . . . .	3
A. Purpose of the Guide . . . . .	3
B. Key features and benefits of the Model Law . . . . .	3
C. Some things to bear in mind . . . . .	5
II. How to engage in secured transactions under the Model Law . . . . .	7
A. How to take an effective security right . . . . .	7
B. A key preliminary step for secured financing: due diligence . . . . .	18
C. Searching the Registry . . . . .	24
D. Preparing the security agreement . . . . .	28
E. Registering a notice in the Registry . . . . .	31
F. The need for continued monitoring . . . . .	44
G. Determining the priority of a security right . . . . .	47
G bis. Extinguishment of a security right . . . . .	51
H. How to enforce a security right . . . . .	51
I. Transition to the Model Law . . . . .	57
J. Issues arising from cross-border transactions . . . . .	59
III. The interaction between the Model Law and the prudential regulatory framework . . . . .	62
A. Introduction . . . . .	62



---

B. Key terminology.....	63
C. Enhancing coordination between the Model Law and national prudential regulation .....	64
Annexes	
Annex I: The Model Law and work by UNCITRAL in the area of secured transactions	68
Annex II: Glossary .....	69
Annex III: Sample Diligence Questionnaire.....	73
Annex IV: Sample security agreements .....	77
Annex V: Sample retention-of-title clause .....	82
Annex VI: Sample template for grantor’s authorization for registering a notice in the Registry .....	83
Annex VII: Sample template for requesting the registration of an amendment or cancellation notice .....	84
Annex VIII: Sample borrowing base certificate.....	85
Annex IX: Template for disposing the encumbered asset .....	86
Annex X: Template for proposing the acquisition of the encumbered asset .....	87
Annex XI: Template for payment instructions .....	88

## **I. Introduction**

### **A. Purpose of the Guide**

#### **1. What the Guide is about**

1. This Guide provides practical guidance to parties involved in secured transaction in States that have enacted the UNCITRAL Model Law on Secured Transactions (2016) (the “Model Law” or “ML”). This Guide:

- Explains key features and benefits of the Model Law;
- Illustrates the types of secured transactions that can be undertaken under the Model Law; and
- Provides step-by-step explanations on how to engage in the most common and commercially important transactions

#### **2. Who this Guide is for**

2. This Guide is for readers who wish to understand the Model Law and its application in practice. This chapter provides a summary of the key benefits of the Model Law and things to bear in mind as readers go through the contents of the Guide. Chapter II provides guidance mainly to creditors and debtors (as well as their advisers) on how to engage in several common types of secured transactions. It also provides guidance to others whose rights may be affected by a secured transaction (for example, a buyer of an asset subject to a security right or a judgment creditor). Chapter III is intended primarily for regulated financial institutions and prudential regulatory authorities.

3. This Guide is also useful to other stakeholders, such as policymakers and legislators of States considering whether to adopt the Model Law, as well as judges and insolvency administrators.

### **B. Key features and benefits of the Model Law**

#### **1. Greater access to credit at a reasonable cost**

4. For many businesses, movable assets are the main type of asset that they can offer as collateral. The Model Law makes it easy to use most types of movable assets as security. This means that legislative reforms based on the Model Law make it easier for businesses to access credit, particularly small and medium-sized enterprises. It can also reduce the cost of credit and make it possible for businesses to obtain credit for longer periods of time. Readily available credit at a reasonable cost helps businesses grow and prosper. This also has a positive impact on the economic prosperity of a State as a whole, which is why legislative reforms based on the Model Law are recommended.

#### **2. What is a “security right”?**

5. A “security right” under the Model Law is a property right in a movable asset that enables a person (the “secured creditor”) to secure what it is owed by another person (the “debtor”). A secured creditor can protect itself when the debtor does not pay by applying the value of the asset (the “encumbered asset” or the “collateral”) to recover what it is owed. A secured creditor generally has priority over an unsecured creditor, including in insolvency proceedings.

6. The obligation secured by a security right will most likely be the payment of money by the debtor. However, a security right can also secure non-monetary obligations such as the obligation to perform services under a contract.

7. In most cases, the debtor will be the person who grants the security right (the “grantor”). However, a person can also grant a security right in its assets to secure the obligations of another person.

### **3. A comprehensive secured transactions regime**

8. Some legal systems allow a person to grant a security right in movable assets only to a limited extent or only in a very restrictive way. Even where a legal system allows movable assets to be used as collateral, the rules are often complex or unclear. In some States, a range of mechanisms have been developed to enable creditors to rely on security over movable assets. This has, however, often resulted in overlapping and fragmented secured transactions regimes.

9. In contrast, the Model Law allows a person to grant a security right over:

- Almost any type of movable asset, including inventory, equipment, receivables, bank accounts and intellectual property;
- An asset that it already owns, as well as an asset that it may acquire in the future; and
- All of its movable assets, both present and future.

### **4. A functional approach to secured transactions**

10. The Model Law applies to all transactions under which a property right in a movable asset is created by agreement to secure payment or other performance of an obligation, regardless of the form of transaction, the terms used by the parties to describe the transaction or who owns the asset. Accordingly, the Model Law applies to transactions in which the creditor retains or transfers title of an asset to secure payment or other performance of an obligation, for example, retention-of-title sales, financial leases and sale-and-leaseback. Those transactions are all regarded as creating a security right under the Model Law.

### **5. A simple way to create a security right**

11. It is easy to create a security right under the Model Law. The parties only need to enter into a security agreement that satisfies the simple requirements of the Model Law. Unlike some secured transactions regimes, registration is not a requirement for the creation of a security right. The Model Law allows a person to grant a security right over its asset without having to give possession of the asset to the secured creditor.

12. A security right created in this way will be effective against the grantor and will extend to its identifiable proceeds. For example, if an encumbered asset is sold, the security right will automatically extend to what is received as a result of the sale.

*[Note to the Commission: The Commission may wish to consider deleting paragraph 12 as the extension to proceeds is dealt in more detail in Section II.A.12.]*

### **6. A simple and transparent registration system**

13. A secured creditor will want to make sure that its security right is also effective against third parties, as the security right will otherwise not be of much benefit. The most usual way of making a security right effective against third parties under the Model Law is to register a “notice” in the general security rights registry (the “Registry”).

14. The registration process is straightforward. Secured creditors do not need to submit the security agreement or any other documents. Registrations can be made at any time, even before the parties enter into a security agreement. The Registry under the Model Law should be fully electronic and accessible online not only for registration purposes but also for search purposes.

15. Registration of a notice in the Registry has the following consequences:

- It makes the security right effective against third parties;
- It allows the secured creditor to establish the priority of its security right over rights of competing claimants; and
- Third parties can find out about the potential existence of a security right in a movable asset by searching the Registry.

## **7. Flexibility given to the parties**

16. Under the Model Law, parties have a great deal of flexibility to structure their arrangements as they wish and reflecting the outcome that they want to achieve. In addition, the Model Law provides a secured creditor with a number of options for enforcing its security right, including by enforcing the security right itself, without having to go to court.

## **C. Some things to bear in mind**

### **1. The Guide is about using movable assets as security for financing**

17. This Guide explains how to use movable assets as security for financing purposes. It does not deal with transactions using immovable property (for example, land or building) as security, as those transactions are not covered by the Model Law. This Guide also does not deal with movable assets that are excluded from the scope of the Model Law (for example, intermediated securities)

18. This Guide is also not a general manual on financing. Guidance on good financing practices is provided only when the financing is affected by the fact that it is secured using movable assets.

### **2. Terminology used in this Guide**

19. The Model Law relies on a number of specific and carefully worded definitions. The glossary in Annex II provides an explanation of some of the key terms used in this Guide along with examples. Readers should always rely on the precise language of the Model Law as enacted in the State to structure their transaction and to understand how the law would apply to their transaction.

### **3. The Guide does not address everything in the Model Law**

20. This Guide explains how the Model Law works in a general and non-legalistic way without going into every detail. Readers should bear this in mind, including when referring to the sample texts provided in the Annex.

### **4. The Model Law has options**

21. Some articles of the Model Law contain options for enacting States to choose in their legislation. This Guide provides guidance on each of the different options. Readers should determine which option has been chosen by the enacting State and use this Guide accordingly.

### **5. Other laws may be relevant**

22. The Model Law does not operate in a vacuum. Other laws, such as contract law, property law, intellectual property law, negotiable instruments law, consumer protection law, insolvency law, banking law, and civil procedure law, will influence how the Model Law operates in the enacting State. International treaties and conventions applicable in the enacting State may also be relevant. Readers should determine how these other laws may affect transactions under the Model Law.

23. In certain cases, the Model Law contemplates this interaction. For example, article 37 provides that the steps that a judgment creditor needs to take to acquire rights in the encumbered asset may be set out in other laws of the enacting State. Even when not expressly contemplated by the Model Law, other laws may still apply. These laws may not be specific to secured transactions. For example, rules of contract law that set out what parties need to do to enter into a binding contract may apply to security agreements.

24. There may be other laws that restrict the applicability of the Model Law, for example, a law that limits the parties' ability to enter into a security agreement or a law that imposes limitations on enforcement against certain assets. The law of some States may limit the value of assets that can be encumbered relative to the value of the secured obligation (often referred to as "overcollateralization").<sup>1</sup> Readers should check if the laws of the enacting State imposes any such limitation.

*[Note to the Commission: The Commission may wish to consider whether the text below should be retained in the box after Part I.C or constitute Part D of Chapter I. The current placement reflects the decision by the Working Group to place the text under Part I.C, but is presented in a separate box as it addresses a topic quite distinct from others in Part I.C.]*

<Secured transactions involving microenterprises>

The Model Law is designed to improve access to credit and to lower the cost of credit for all kinds of businesses. It is particularly well suited for small and medium-sized enterprises, which are the most common form of businesses in most States. The Model Law also enables secured lending to microenterprises, which might have had only limited access to credit because mechanisms suitable to secure loans to micro-enterprises were not readily available or because the related cost was too high.

Suppose an individual, Ms. X applies for a loan to start a business selling food on the street. Ms. X does not have any business assets, only household items such as her cooking equipment. Lender Y provides Ms. X with a three-month loan secured over the household items, which Ms. X uses to purchase supplies for her business. Ms. X decides to call her business "Home Cooking". After three months, Home Cooking is successfully established, and Ms. X can repay the loan. Ms. X then applies to Lender Y for a larger loan. Lender Y provides the loan, this time secured over supplies purchased by Ms. X for the business and money made by Ms. X from the sale of food.

This is an example of secured financing of a microenterprise. It illustrates certain features that are typical of many microenterprises and of their secured financing. The amount of the loan is likely to be very small. Ms. X is an individual and her business is not incorporated, so the loan is made to Ms. X personally, even though the business might operate under the trading name "Home Cooking". There is little distinction between the business and the individual who owns and runs the business, or between the business and household assets provided as security.

As is typical for many microenterprises, Ms. X does not need to register her business in any public registry. Therefore, information about the legal or financial status of the business and the name and address of the individual who operates the business are unlikely to be publicly available. Even when Home Cooking is well established, Ms. X may not have kept accounting records that the lender could look at it understand the cash flows. It is also likely that the income and expenditure of the business will have been mixed up with those of Ms. X.

These features present Lender Y with some challenges when it assesses whether and how to extend credit to Ms. X. The lack of formal financial information (including from credit bureaus) and public registration of the business may affect the type of due diligence that Lender Y needs to undertake. This means that when

<sup>1</sup> See UNCITRAL Legislative Guide on Secured Transactions, Chapter II, paras. 68–69.

registering a notice in the Registry, Lender Y should ensure to use the name of Ms. X and not the trading name “Home Cooking”.

Lender Y should also closely monitor the business of Ms. X during the period of the loan, so that it becomes aware of any changes in name, address, legal status, location of the assets or other matters, which could adversely affect Lender Y’s security right, including the ability to enforce it.

As a more general point, Lender Y should also bear in mind that its ability to create or enforce its security right may be limited by other laws of the enacting State, such as those prohibiting the creation of security rights in household goods or the seizure of personal assets and those limiting the amount for which a security right can be enforced.

## II. How to engage in secured transactions under the Model Law

25. This Chapter is addressed mainly to parties who engage in secured transactions. It describes how to carry out a number of common or important types of secured transaction under the Model Law. This Chapter will also be useful for others that might be affected by a secured transaction, such as a potential buyer of an encumbered asset, other creditors of a grantor and insolvency representatives.

26. The transactions described in this Chapter are by no means the only types of transaction that are possible under the Model Law. For example, transactions described in this Chapter may be combined to develop a wide range of secured financing products. In this way, the Model Law facilitates supply chain financing and value chain arrangements as well as more complex financing arrangements such as syndicated lending and securitization.

*[Note to the Commission: As introductory paragraphs of this Chapter, the above two paragraphs have been drafted in summary fashion and do not incorporate all of the details that were contained in paragraph 45 of document A/CN.9/967, particularly as the contents of that paragraph seemed to be repetitive.]*

### A. How to take an effective security right

#### 1. Security over tangible assets without having to take possession

**Example 1A:** Company X has a printing business and wants a loan from Bank Y. Bank Y is willing to make the loan if it can take security over Company X’s printing press. However, Company X needs to keep possession of the printing press, so that it can continue to operate its business.

27. To obtain a security right in the printing press, Bank Y needs to:

- Make sure that Company X can grant a security right in the printing press; and
- Have Company X create a security right over the asset in favour of Bank Y.

*Can Company X grant a security right?*

28. To grant a security right, the grantor needs to have rights in the asset to be encumbered or the power to encumber it (ML art. 6(1) and (2)). In most cases, the grantor will be the owner of the asset and this will be enough to enable it to grant a security right in that asset.

29. There may also be circumstances where a person is able to grant a security right even though that person is not the owner. For example, if Company X was renting a

printing press under a lease agreement, it could grant a security right in its right to use the printing press under the lease agreement, but not in the printing press itself.

30. A person can also grant a security right in asset when it has the power to encumber it. For example, a person may have been authorized by the owner of an asset to create a security right in the asset in favour of a secured creditor. Also, even if the owner of a receivable sells the receivable, it may have the power to encumber the same receivable to another person, if the transferee did not meet the requirements to make its right in the receivable effective against third parties.

*[Note to the Commission: While the Model Law provides that a grantor may grant a security right in rights other than ownership if it has the power to encumber the asset, it might be confusing to the readers if such an example is included in the draft Practice Guide. The Commission may wish to consider whether to retain paragraph 30.]*

#### *Security for obligations owed by third parties*

31. The grantor will usually be the person who owes the secured obligation. However, the Model Law also allows a person to grant a security right in its assets to secure an obligation that is owed by another person. For example, Company X can grant a security right over the printing press to secure a loan made to Company Z.

32. This type of arrangement is common when financing is provided to a group of companies (see example 6). In such a case, each company in the group will grant a security right in its assets to secure the obligations of all other members of the group. Another example of such an arrangement is when a family member provides its assets as security for a loan made to another member of the family. Readers should note that these types of arrangements may be limited or prohibited under other laws.

*[Note to the Commission: The fact that there are other laws that may apply to secured transactions is highlighted in Chapter I.C.5. The Commission may wish to consider whether the last sentence of paragraph 32 would need to reiterate that point or could be deleted on the basis that it is repetitive.]*

#### *Creating a security right – the security agreement*

33. To obtain a security right in the printing press, Bank Y needs to enter into an agreement with Company X that creates a security right in Bank Y's favour (the "security agreement"). It is not necessary for Bank Y to take possession of the asset, and the printing press can stay in the possession of Company X so that Company X can keep using it.

34. The Model Law sets out some minimum requirements for a security agreement (ML art. 6(3)). The security agreement needs to:

- Be in writing and signed by Company X;
- Identify the parties (Bank Y as the secured creditor and Company X as the grantor);
- Describe the obligation that is secured; and
- Describe the encumbered asset (the printing press) in a way that reasonably identifies it.

35. If the enacting State requires the security agreement to indicate the maximum amount for which the security right may be enforced (ML art. 6(3)(d)), that amount would also need to be stated in the security agreement.

#### *How can Bank Y make its security right effective against third parties?*

36. A security right that is created in the way described above will be enforceable against Company X. However, Bank Y will want to ensure that its security right is also effective against third parties. Otherwise, Bank Y might not be fully protected if

Company X becomes insolvent, or if Company X sells the printing press or grants a security right in the printing press to another person.

37. The most usual way in which Bank Y can make its security right in the printing press effective against third parties is to register a notice in the Registry that describes the printing press (on how to register, see Part II.E). Third parties can then find out about the potential existence of Bank Y's security right in the printing press by searching the Registry.

*Taking an effective security right over more than one asset of the grantor*

**Example 1B:** Company X operates a conference management business and owns a number of high-quality projectors. It wants a loan from Bank Y. Bank Y is willing to make the loan if it can take security over all of Company X's projectors.

38. The Model Law allows a secured creditor to take security over more than one asset of the grantor at the same time (ML art. 8). As in example 1A, Bank Y simply needs to ensure that the description of the encumbered assets in the security agreement and in the notice covers all of Company X's projectors, rather than just a single projector. This can be done by listing all of the projectors individually (for example, by listing the respective manufacturer and serial number), or by describing them in a generic manner (for example, "all projectors") (ML art. 9, see Section II.E.5).

## 2. Security over tangible assets by taking possession

**Example 2:** Designer X wants a loan from Bank Y to start her own business. Designer X does not yet have any business assets to provide as security but does own some antique jewellery. Bank Y is willing to make the loan if it can take security over the jewellery.

39. To obtain an effective security right in the jewellery, Bank Y needs to:

- Make sure that Designer X owns the jewellery;
- Have Designer X create a security right in the jewellery in favour of Bank Y; and
- Ensure that its security right is effective against third parties.

40. As in example 1A, Bank Y can enter into a written security agreement with Designer X and register a notice in the Registry. However, in example 2, Bank Y may wish to take possession of the jewellery instead. If Bank Y takes possession of the jewellery, it does not need to register a notice in the Registry to make its security right effective against third parties (ML art. 18(2)).

41. Even though Bank Y does not need to register a notice in the Registry to make its security right effective against third parties if it takes possession of the jewellery, it will be prudent for Bank Y to register a notice as well. This will help Bank Y to keep its security right effective against third parties should it later agree to give up possession of the jewellery.

## 3. Security over present and future assets

**Example 3:** Farmer X trades beef cattle and wants a loan from Bank Y to purchase feed. Bank Y is willing to make the loan if it can take security over Farmer X's cattle, including cattle that Farmer X purchases in the future.

42. The Model Law allows a grantor to grant a security right not only in assets that the grantor already has, but also over assets which do not yet exist, or in which the grantor does not yet have rights, at the time the security agreement is entered into (ML art. 6(2), for the definition of "future asset", see ML art. 2 (n)).

43. To take security over the cattle, Bank Y simply needs to take the same steps as in example 1A. The only difference is that Bank Y needs to describe the encumbered assets, in both the security agreement and the notice, to include cattle that Farmer will purchase in the future, with a phrase such as “all cattle, both present and future”. This way:

- Bank Y takes security over cattle already owned by Farmer X when the security agreement is entered into; and
- Bank Y will obtain a security right in additional cattle as they are purchased by Farmer X in the future.

44. Bank Y does not need to enter into a separate security agreement or to register another notice after Farmer X purchases the additional cattle, as it automatically takes security over that cattle as they are purchased by Farmer X.

#### 4. Security over all movable assets (all-asset security)

**Example 4:** Travel Agency X organizes jungle safaris and plans to expand its offering to include white-water rafting expeditions. It wants a loan from Bank Y to cover the expansion costs. Bank Y is willing to make the loan if it can take security over all Travel Agency X’s assets, including future assets.

45. Taking security over all of a grantor’s movable assets, both present and future, is no more difficult than taking security over a single existing asset. Bank Y simply needs to take the same steps as in previous examples. The only difference is that Bank Y should describe the encumbered assets, in both the security agreement and the notice, to encompass all of the assets, with a phrase such as “all movable assets, both present and future”. This will give Bank Y a security right in all of Travel Agency X’s movable asset at the time the security agreement is entered into and movable assets that Travel Agency X acquires in the future.

46. Depending on the type of assets that Travel Agency X has, Bank Y may need to take additional steps to ensure that its security right in those assets have priority (see example 6 (shares), example 7 (bank accounts), example 8 (negotiable instruments) and example 11 (intellectual property), see also Section II.E.11 for assets that might require registration in an asset-specific registry).

47. If Travel Agency X is not able to repay the loan, Bank Y can enforce its security right by disposing of the assets separately, or by disposing of all of them together. In either case, Bank Y needs to undertake the sale of assets in accordance with the enforcement provisions of the Model Law (on how to enforce a security right, see Part II.H). The fact that Bank Y is able to dispose all the assets together may make it easier for Bank Y to sell the business of Travel Agency X in its entirety, if this is possible under other laws of the enacting State.

#### 5. Financing the acquisition of tangible assets

**Example 5A (Retention-of-title finance):** Company X wants to purchase drilling equipment from Vendor Y. Rather than Company X paying the price on delivery, Vendor Y is willing to give 30-day credit terms to Company X. Vendor Y’s terms of sale state that it retains title to the equipment until Company X has paid the purchase price in full.

**Example 5B (Vendor purchase finance):** Company X wants to purchase paint from Vendor Y. Rather than Company X paying the price on delivery, Vendor Y is prepared to give 30-day credit terms to Company X, as long as Company X grants Vendor Y a security right in the paint for the unpaid purchase price.

**Example 5C (Purchase loan finance):** Company X wants to purchase computers from Vendor Y. Vendor Y has an arrangement with Bank Z to help its customers with financing. Company X finances the purchase of the computers with a loan from Bank Z. Bank Z is willing to make the loan if Company X grants a security right in its computers. The proceeds of Bank Z's loan to Company X is used to pay Vendor Y.

**Example 5D (Lease finance):** Company X wants to purchase computers from Vendor Y. Rather than Company X financing the purchase with a loan from Bank Z, Vendor Y agrees to lease the computers to Company X instead, for a three-year period. The rent under the lease is sufficient to cover Vendor Y's capital investment in the computers and its cost of funding the lease. At the end of the lease term, Company X can purchase the computers for a nominal sum.

48. All these examples involve situations where a security right is created under the Model Law, even though only examples 5B and 5C expressly refer to Company X granting a security right in the assets. This is because the Model Law covers all transactions under which a property right in a movable asset is used to serve a security function, regardless of the form of the transaction or of who has title (see Sections I.B.2 and 4).

49. In examples 5A and 5B, Vendor Y provides short-term credit for the purchase. In example 5A, Vendor Y uses the drilling equipment as security for the unpaid purchase price. Under the terms of the sale agreement, Company X does not become the owner of the drilling equipment until the purchase price is paid. This is a common security mechanism in many traditional legal systems. The Model Law looks to the underlying commercial objectives of the transaction and recognizes that the retention of title by Vendor Y is a security mechanism. Vendor Y is regarded as having a security right in the drilling equipment, and the retention-of-title sale agreement is regarded as a security agreement. Vendor Y needs to meet the requirements in the Model Law to have an effective security right. If the sale agreement describes the drilling equipment in a way that reasonably identifies it, is signed by Company X, and satisfies the other requirements for a security agreement, then Vendor Y will have a security right in the drilling equipment that is effective against Company X. To make its security right effective against third parties, Vendor Y also needs to register a notice in the Registry.

50. Vendor Y would not obtain greater protection by using a retention-of-title clause in the sale agreement because the Model Law regards the retention-of-title sale as creating a security right. If Company X defaults, Vendor Y cannot simply take the drilling equipment back. It needs to enforce its security right in the equipment in accordance with the enforcement provisions of the Model Law (see Part II.H). If there is any amount exceeding what is owed by Company X, Vendor Y needs to return the surplus to Company X.

51. In example 5B, Vendor Y is selling paint to Company X on short-term credit. This is in effect a short-term loan of the purchase price by Vendor Y, the payment of which is secured by Vendor Y's security right in the paint. Vendor Y needs to follow the same steps as in example 5A to take an effective security right.

52. In examples 5C and 5D, Company X is obtaining long-term financing to acquire the computers. The Model Law applies in the same way as in examples 5A and 5B. In example 5D, while the transaction may be set up as a lease, the lessor (Vendor Y) uses the computers to secure Company X's obligation to pay the purchase price and other amounts owing to it under the lease. As in example 5A, Vendor Y is regarded as having a security right in the computers, and the lease agreement is regarded as a security agreement. If the lease agreement describes the computers in a way that reasonably identifies them, is signed by Company X, and satisfies the other requirements for a security agreement, then Vendor Y will have a security right in the

computers that is effective against Company X. To make its security right effective against third parties, Vendor Y also needs to register a notice.

53. While the financing in example 5D is provided by the seller of the computers, lease finance can also be provided by banks and other financial institutions. Where that is the case, the financier will buy the computers from the vendor, and then lease them to Company X.

54. The security rights in examples 5A to 5D are “acquisition security rights” under the Model Law, because Vendor Y or Bank Z is taking security over an asset to secure credit that has enabled Company X to acquire the asset (ML art. 2(b)). If Vendor Y or Bank Z complies with article 38 of the Model Law, its security right in the drilling equipment or the computers will have priority over security rights of non-acquisition secured creditors in those assets, even if they had previously registered a notice that covers those assets (see Section G.3). This is an important exception to the first-to-register rule of the Model Law, which provides that the priority between competing secured creditors is determined by the order in which the notices are registered (see Section G.1).

## 6. Security over a company’s shares

**Example 6:** A manufacturing business is operated through a group of private wholly-owned companies. Mr. X owns all the shares in Company A, the holding company of the group. Company A owns all the shares in three subsidiaries, Companies B, C and D. The shares are represented by certificates. Company A wants a loan to expand the operations of the group. Bank Y is willing to make the loan if it can take security over all the assets of all the companies in the group.

55. For Bank Y to take security over all the assets of all the companies of the group, it will need to take an all-asset security from Company A (including over all its shares in Companies B, C and D) in the same way as in example 4. It will also need to take an all-asset security from Companies B, C and D, in the same way as in example 4.

56. In example 6, the borrower is Company A. As Companies B, C and D are not the borrower, Bank Y may require each of them to provide a guarantee of Company A’s obligation (subject to other laws of the enacting State which may limit the use of such guarantees). If Companies B, C and D do provide guarantees, the security right granted by each company will usually secure their obligations under their guarantee.

57. To strengthen its position further, Bank Y can also require as a condition for its financing that Mr. X grant a security right in his shares in Company A. This would give Bank Y an additional enforcement option, because it can then sell the group in its entirety (by selling the shares in Company A). This is likely to be simpler than Bank Y selling the group’s assets separately.

58. Bank Y should make each of its security rights effective against third parties by registering notices in the Registry identifying each of Company A, Company B, Company C, Company D and Mr. X as a grantor. Bank Y can also make its security rights over the shares in each of the companies effective against third parties by taking possession of the certificates as in negotiable instruments (see section II.A.8 and example 8). The advantage of taking possession is that Bank Y will have priority over any competing security right created by the same grantor that is made effective against third parties by registration, even if the other secured creditor registered its notice before Bank Y took possession (ML art. 51(1)).

59. Shares in privately-held corporate groups may not always be represented by certificates. If this had been the case in example 6, Bank Y would not have been able to make its security right in the shares effective against third parties by taking possession. Bank Y could instead have made its security right in the uncertificated shares effective against third parties by doing one of the following:

- Bank Y could arrange for its security right to be recorded in the shareholder register maintained by each company or for Bank Y to be registered in the shareholder register as the holder of the shares (ML art. 27(a)); or
- Bank Y could enter into a control agreement with each issuer of the shares and the grantor (ML art. 27(b)). For the shares of Company B, the control agreement would be between Bank Y (secured creditor), Company B (issuer) and Company A (holder of the shares and grantor). The control agreement would require Company B to follow Bank Y's instructions with respect to the shares, without requiring any further consent from Company A (ML art. 2(g)(i)).

60. Similar to taking possession of certificated shares, these methods of achieving third-party effectiveness of a security right in uncertificated shares can ensure priority over a competing security right that was made effective against third parties by registration (ML art. 51(2) and (3)).

61. The Model Law applies to example 6 because the shares in the example are “non-intermediated securities” (ML art. 2(w)). The Model Law does not apply, however, to security rights in intermediated securities, that is, securities that are held through an intermediary or credited to a securities account (ML art. 1(3)(c)). If a secured creditor wants to take security over intermediated securities, then it will need to rely on other laws of the enacting State.

## 7. Security over bank accounts

**Example 7A:** Company X needs a loan to cover operating expenses. Its main assets are a printing press and funds in its bank account with Bank Y. Bank Z is willing to make a loan by taking security over Company X's printing press. However, Bank Z also wants to take security over the bank account with Bank Y, to protect itself against the risk that the printing press might unexpectedly depreciate in value.

62. Like any other movable asset, it is possible to take a security right in a right to payment of funds credited to a bank account (referred to in this Guide, simply as taking a security right “in a bank account”). Taking an effective security right in a bank account is no more difficult than taking security over a printing press or any other type of asset. As in example 1A, Bank Z simply needs to enter into a security agreement and register a notice. The security agreement and the notice should describe the encumbered asset as the printing press and the bank account. The bank account can be described by identifying the bank where Company X maintains its account and stating the account number. Alternatively, a phrase such as “all bank accounts, both present and future” can be used. This would give Bank Z security over all Company X's bank accounts, even if Bank Z was unaware of them at the time it made the loan.

63. However, as the bank account is maintained at another bank, Bank Z may want to make its security right in the bank account effective against third parties by entering into a control agreement (ML art. 25(b)). This is usually a three-party agreement between Company X, Bank Y and Bank Z, which provides that Bank Y will follow the instructions of Bank Z with respect to the payment of funds from the account, without requiring any further consent from Company X (ML art. 2(g)(ii)). A control agreement would give Bank Z's security right priority over competing security rights in the bank account that were made effective against third parties by only registering a notice (ML art. 47(3)).

64. The control agreement will typically provide that Bank Z can instruct Bank Y to transfer the funds directly to it if Company X defaults. It will also often provide Bank Z with additional protection, for example, by limiting Company X's ability to withdraw funds from the account. If Bank Y is unwilling to agree to terms that Bank Z considers important, Bank Z can require Company X to move the account to Bank Z instead.

65. If Bank Z wants to take security over all of Company X's present and future bank accounts, it will not be possible as a practical matter to enter into a control agreement with all potentially-relevant banks. This means that Bank Z's security right in any unknown or future bank accounts of Company X can only be made effective against third parties by registering a notice.

**Example 7B:** In example 7A, Bank Y, instead of Bank Z, is willing to make the loan if it can take security over Company X's printing press and the bank account.

66. As in example 7A, Bank Y can take security over Company X's bank account by describing the bank account in the security agreement and in the notice. As Company X has the bank account with Bank Y, Bank Y's security right in that bank account will be automatically effective against third parties. This means that Bank Y does not need to register a notice describing the bank account (ML art. 25(a)).

67. Bank Y's security right in the bank account will generally have priority over any competing security right in that bank account, unless the other secured creditor becomes the holder of the account (ML art. 47(2)).

## 8. Security over negotiable instruments

**Example 8:** Company X is owed a large sum of money by Company Y. Company Y issues a negotiable instrument to Company X under which it promises to pay the money to Company X in instalments, over a five-year period. Company X needs a loan to pay operating expenses and wants to use the negotiable instrument as security for the loan. Bank Z is willing to make the loan on that basis.

68. Bank Z can take security over the negotiable instrument by entering into a security agreement that describes the encumbered asset as "a negotiable instrument signed by Company Y on DD/MM/YYYY, payable to Company X, in the amount of (the face amount stated in the instrument)". If Company X regularly receives negotiable instruments as payment in the course of its business and is willing to give Bank Z a security right in all of them, Bank Z can take security over all existing and after-acquired negotiable instruments by entering into a security agreement that describes the encumbered assets as "all negotiable instruments in favour of Company X, both present and future".

69. As in other examples, Bank Z can make its security right effective against third parties by registering a notice using the same description mentioned above. However, Bank Z should consider making its security right effective against third parties by taking possession of the negotiable instrument either in addition to or instead of registering a notice. One advantage of taking possession is that Bank Z will have priority over any competing security right that was made effective against third parties by registration, even if the notice was registered before Bank Z took possession (ML art. 46(1)). Another advantage is that Bank Z will be protected against a buyer or other consensual transferee of the encumbered negotiable instrument (ML art. 46(2)).

## 9. Outright transfer of receivables

**Example 9:** Company X is in the business of selling commercial refrigerators to customers. Because the cost of refrigerators is quite high, Company X often agrees to allow customers to pay over time, rather than on delivery. This creates a pool of receivables, which is Company X's most valuable asset. Company X needs cash before the receivables are due so that it can pay its suppliers and cover other operating expenses. Factor Y agrees to provide Company X with cash by purchasing the receivables.

70. Businesses often raise funds for its operation with the receivables that they generate, rather than waiting for the receivables to be paid. Sometimes they transfer the receivables to a financier so that they serve as security for the financing.

Sometimes they transfer the receivables to a financier outright, often at a discount. This type of a financier is often referred to as a “factor”. Factoring businesses provide a number of different types of products as transfers of receivables may also be combined with other methods of finance, for example, supply chain financing and receivables securitization.

71. The Model Law applies to all transfers of receivables, including outright transfers (ML art. 1(2)). Under the Model Law, the transferor of a receivable is generally regarded as a grantor, the transferee as a secured creditor, and the agreement between them as a security agreement. Accordingly, the provisions in the Model Law apply to all transfers of receivables.

72. One reason why the Model Law applies to outright transfers of receivables is that it is often difficult to tell whether a receivable is being transferred outright or is being transferred for security purposes. Applying the provisions of the Model Law to all transfers of receivables regardless of their purpose reduces the need to make this distinction. Another benefit of this approach is that the provisions of the Model Law will determine priority among all competing rights in the same receivable, including the rights of an outright transferee.

73. As in other examples, Factor Y in example 9 will need to enter into an agreement with Company X that satisfies the requirements of a security agreement. It will also need to register a notice in the Registry to make Factor Y’s ownership in the receivables effective against third parties.

74. An outright transfer of receivables involves or impacts the debtor of the receivable (customers of Company X). Factor Y should take into account the provisions of the Model Law that deal with the protection of the debtors of the receivables (ML arts. 61–67). As a general rule, the transfer of a receivable does not affect the rights and obligations of the debtor of the receivable, unless they have been notified of the transfer. Even after the notification, a debtor of the receivable may be able to raise against Factor Y any defences and rights of set-off arising from the underlying contract or any other contract that was part of the same transaction (ML art. 64(1)).

75. Factor Y should also be aware that the enforcement provisions of the Model Law (ML arts. 72 to 82) do not apply to outright transfers of receivables. That is because a transferee under an outright transfer is the owner of the receivable and is entitled to whatever it collects, regardless of the amount it paid for the receivable. This means that Factor Y bears the risk of not being able to collect the face value of the receivable (referred to as “non-recourse factoring”), unless the parties have agreed otherwise (referred to as “recourse factoring”). This also means that Factor Y does not need to return to Company X any amount that it collects on the receivable in excess of the amount that it paid to Company X.

## 10. Inventory and receivables financing

**Example 10:** Company X sells kitchen appliances to restaurant owners. Restaurant owners are given 60 days to pay for the appliances. Company X does not take security over the kitchen appliances of the unpaid purchase price. While awaiting payment from the restaurant owners, Company X needs money to acquire inventory and to pay operating expenses.

Aware of Company X’s business cycle, Bank Y is willing to provide Company X with a line of credit or a revolving loan, under which Company X can draw down a loan when it needs money to buy inventory or pay other expenses. Payments made by the restaurant owners are used to repay the line of credit. This type of arrangement helps Company X to avoid borrowing more than it needs and keeps the cost of financing at a minimum. Borrowings and repayments can be frequent, and the outstanding loan amount can constantly fluctuate.

Bank Y takes security over all of Company X's existing and future inventory and receivables. Bank Y also takes security over Company X's bank account with Bank Y, into which Company X deposits the payments it receives from the restaurant owners. The pool of the encumbered asset can also constantly fluctuate, as inventory is acquired and converted into receivables, the receivables are collected, and new inventory is acquired.

76. Taking security over all existing and future inventory and receivables is no more difficult than taking a security right in a piece of equipment. Bank Y simply needs to enter into a security agreement and register a notice describing the encumbered asset as "all inventory and receivables, both present and future". To take an effective security right in the bank account, Bank Y needs to take the same steps as in example 7B.

77. In example 10, a restaurant owner may want to include a term in the contract giving rise to the receivable that Company X is not allowed to grant a security right in the receivable to a third party. Even if Company X and a restaurant owner had agreed to this, that limitation would not prevent Bank Y from obtaining a security right in the receivable (ML art. 13(1)). Company X would be liable to the restaurant owner for the breach of their agreement, but the restaurant owner would not be able to avoid its obligation under the contract on the sole ground of the breach of that contract or raise against Bank Y any claim it may have as a result of the breach against Company X (ML art. 13(2)).

*[Note to the Commission: The Commission may wish to consider whether paragraph 77 that explains article 13 of the Model Law should be retained. This is the only place where reference is made that article in the Practice Guide.]*

78. As in example 9, Bank Y should take into account the provisions of the Model Law that deal with the protection of the debtors of the receivables. The restaurant owners in example 10 may have defences or rights of set-off against Company X, which could reduce the value of the receivables. As a way to manage this risk, Bank Y could ask Company X to require the restaurant owners to agree not to raise any defences or rights of set-off (ML art. 65).

## 11. Security over intellectual property

**Example 11:** Company X is a textile manufacturer that needs a loan. It holds patents to protect its inventions in the fabrics, trademarks under which it markets its products, and copyrights in its advertising materials. Company X also holds a licence to use a patented production method in manufacturing its products. Bank Y is willing to make the loan if it can take security over all Company X's present and future intellectual property rights (including intellectual property licences).

79. The Model Law applies to security rights in intellectual property to the extent that its rules are not inconsistent with the enacting State's intellectual property laws (ML art. 1(3)(b)). The following discussion assumes that there is no inconsistency.

80. Bank Y can take security over all Company X's present and future intellectual property rights and intellectual property licences and make its security right effective against third parties by entering into a security agreement and registering a notice in the same way as in previous examples. The security agreement and the notice can describe the encumbered assets as "all intellectual property and rights as licensee of intellectual property, both present and future".

81. Bank Y should be aware that its security right in intellectual property does not extend to any tangible assets with respect to which the intellectual property is used (ML art. 17). For example, Bank Y's security right in Company X's trademarks will not extend to any textile products manufactured by Company X that bear those

trademarks. If Bank Y wants to take security over those products, it will need to describe them in the security agreement and the notice as encumbered assets.

## 12. Security right extending to proceeds

**Example 12:** Company X obtains a loan from Bank Y. It grants Bank Y a security right in its printing press as security for the loan. Bank Y registers a notice in the Registry. Company X later sells the printing press to Company Z. Company X receives a cheque from Company Z in payment.

82. Bank Y's security right in the printing press extends to the cheque received by Company X from Company Z. This is because a security right in an encumbered asset automatically extends to its identifiable proceeds (ML art. 10). "Proceeds" are defined broadly in the Model Law, as any asset in any form that is derived from, or received in respect of, the original encumbered asset (ML art. 2(bb)). Proceeds will usually be a substitute for the value of the encumbered asset, or revenue derived from it.

83. The cheque received by Company X is only one example of proceeds. If the printing press were damaged or destroyed by fire, Bank Y's security right would extend to any insurance claim made by Company X. If the printing press were leased to Company Z, Bank Y's security right would extend to any rent received by Company X under the lease agreement. The same would apply if the printing press were exchanged for another item of equipment.

84. The broad notion of proceeds under the Model Law also includes "proceeds of proceeds". For example, if Company X used the cheque received from Company Z to purchase a new copying machine, that copying machine would also be proceeds, and Bank Y's security right would automatically extend to the copying machine.

85. A security right in proceeds is effective against the grantor as soon as the proceeds arise. However, a secured creditor may have to take additional steps to make its security right in the proceeds effective against third parties. This will depend on what type of asset the proceeds are.

86. In example 12, Bank Y registered a notice with regard to the printing press. If the proceeds are money, receivables, negotiable instruments or funds in a bank account, Bank Y does not need to take any additional steps to make its security right in the proceeds effective against third parties (ML art. 19(1)). In example 12, Bank Y's security right in the cheque received by Company X is automatically effective against third parties (on the basis that a cheque is either a receivable or a negotiable instrument in the enacting State). The result would be the same if Company X deposited the cheque into its bank account. However, Bank Y's security right in Company X's bank account is fragile, as the deposited amount would be commingled with other funds in the bank account. In that case, the Bank Y's security right in the bank account is limited to the deposited amount and terminates if the balance of the bank account later falls below the value of the balance immediately before the funds were deposited (ML art. 10(2)). And, even if Bank Y retains its security right in the bank account, its priority may become subordinate to a security right granted in favour of the depository bank or in favour of a secured creditor who enters into a control agreement with the depository bank (see examples 7A and 7B).

87. If the proceeds are any other type of asset, Bank Y's security right in the proceeds will initially be effective against third parties for a short period after the proceeds arise. After that period, it will only continue to be effective against third parties if Bank Y separately makes its security right in the proceeds effective against third parties before the expiry of that period (ML art. 19(2)).

88. For example, in order to preserve the third-party effectiveness of Bank Y's security right in the copying machine (which Company X purchased with the cheque received from Company Z), Bank Y should register a notice describing the copying machine before the expiry of the time period (see Section II.E.8 and example 18).

Another way to ensure that Bank Y's security right in the copying machine is effective against third parties is to include the description of potential proceeds in the security agreement and in the notice (for example, "all present and future equipment"). This would make the proceeds an original encumbered asset.

89. In addition to Bank Y's security right in the printing press extending to the cheque from Company Z as proceeds, Bank Y's security right may continue in the printing press even after it is sold to Company Z (see Section II.G.2 and example 22). If so, Bank Y can pursue its security right in both the printing press (now owned by Company Z) and the cheque received by Company X. However, Bank Y cannot use its security right in both assets to recover more than what it is owed by Company X (ML art. 79(2)).

### 13. Security over tangible assets commingled in a mass or made into a product

**Example 13A:** Bank Y has a security right in 100,000 litres of oil that are later commingled with 50,000 litres of oil in the same tank, forming a mass of 150,000 litres of oil.

**Example 13B:** Bank Y has a security right in a gold bar worth 10,000 ¥, which is used to make a number of rings worth 30,000 ¥.

90. A security right in a tangible asset that is commingled with other assets of the same kind in a mass, or that is made into a product, extends to the mass or product (ML art. 11(1)). Bank Y's security right extends to the 150,000 litres of oil in example 13A and to the rings worth 30,000 ¥ in example 13B. However, the extent to which a security right extends to a mass or product is limited.

91. If Bank Y had made its security right in the 100,000 litres of oil or the gold bar effective against third parties, its security right would continue to be effective against third parties after the oil was commingled in the tank or the gold bar was made into the rings, without any further act (ML art. 20).

92. When an encumbered tangible asset is commingled in a mass, the security right extending to the mass is limited to the same proportion of the mass as the quantity of the tangible asset bore to the quantity of the entire mass immediately after commingling (ML art. 11(2)). In example 13A, Bank Y's security right is limited to two-thirds of the oil in the tank. If the overall quantity in the tank decreases to 75,000 litres, Bank Y will have security over two-thirds of the oil in the tank (50,000 litres), regardless of any increase or decrease in the value of the oil.

93. Where an encumbered tangible asset is made into a product, the security right extending to the product is limited by reference to the value of the encumbered asset immediately before it became part of the product (ML art. 11(3)). In example 13B, Bank Y's security right in the rings would be limited to 10,000 ¥.

## B. A key preliminary step for secured financing: due diligence

### 1. General

#### *Examining and verifying factual aspects*

94. As described in Part A, the Model Law makes it easy to enter into a wide range of secured transactions. While the legal requirements are straightforward, a secured creditor should also examine and verify a number of factual aspects before entering into a secured financing arrangement. These preliminary steps are referred to as "due diligence" in this Guide. The Model Law does not oblige a secured creditor to conduct due diligence, though it would be prudent to do so. Other laws, however, may require due diligence with respect to certain types of transactions, particularly regulated financial institutions (see Chapter III).

95. This Part provides guidance on how to conduct due diligence when engaging in secured transactions under the Model Law. It does not address due diligence in relation to unsecured lending or lending in general.

*Appropriate level of due diligence*

96. Due diligence helps a secured creditor to assess whether the debtor will be able to repay the loan, and whether the potential value of the encumbered asset will be sufficient to secure the loan. Due diligence can also help a secured creditor to uncover potential risks in the transaction, so that it can deal with those risks in advance.

97. The appropriate level of due diligence for a particular transaction will depend on a number of factors, including who the grantor is, the type of secured transaction, and the type of the asset to be encumbered. The level of due diligence will also have an impact on the cost of financing.

*Using third parties for due diligence*

98. A secured creditor can use third parties to assist with its due diligence. For example, a secured creditor can use a credit bureau to assess the credit-worthiness of a grantor, or it may consult an industry analyst to develop an understanding of the strengths and weaknesses of the industry in which the grantor operates. A secured creditor may also use experts to inspect the grantor's premises, books and records, or appraisers to assess the value of the assets over which it will be taking security.

*Questionnaire as a starting point for due diligence*

99. A secured creditor will often begin its due diligence by asking the grantor a series of questions. An example of such a questionnaire, referred to in practice also as a "checklist" or "certificate", is found in Annex III ("Sample Diligence Questionnaire"). While the Sample Diligence Questionnaire contains information that a secured creditor would seek from a grantor in a rather complex transaction, it will need to be modified, sometimes simplified, to reflect the circumstances of each transaction. Once the grantor answers the questionnaire, the secured creditor should take appropriate steps verify the correctness of the information contained therein.

*Need for continued monitoring*

100. This Part focuses on the preliminary steps to be taken by a secured creditor before entering into a secured transaction. However, a secured creditor should continue to monitor the status of the grantor and of the encumbered asset throughout the entire duration of the transaction (see Part II.F).

## **2. Due diligence on the grantor**

101. Due diligence on the grantor is an important step before engaging in any secured transaction. However, it will overlap in many aspects with the due diligence that a creditor conducts when making an unsecured loan.

102. As part of its due diligence, a secured creditor should ask the grantor to provide important information about itself relevant to the transaction and its creditworthiness. Some of the information will be relevant to any type of financing arrangement, whether or not it is secured. Some, however, will be particularly important in the context of a secured transaction.

103. For example, a secured creditor should obtain and verify the name of the grantor (section 1 of the Sample Diligence Questionnaire), as using the correct name of the grantor is critical when registering a notice (on what constitutes a correct name, see Section II.E.5). A notice registered using the correct name of the grantor ensures that the security right is effective against third parties. A secured creditor should also ask if there are any other names, present and past, that are attributed to the grantor (see

sections 1(f) and 1(g) of the Sample Diligence Questionnaire, see Section II.C.4, II.E.8 and example 17).

104. Due diligence on the grantor may also involve examining whether there are other laws that limit or restrict the creation of a security right by certain persons or restrict the enforcement of a security right against certain persons or assets of those persons (for example, consumer protection laws, see ML art. 1(5)).

### 3. Due diligence on the asset to be encumbered

105. A secured creditor should first identify which assets of the grantor it intends to take security over. Once the assets are identified, a secured creditor should determine what it needs to do to take an effective security over the assets to be encumbered. For example, where a security right is to be created in all of the grantor's present and future assets, the secured creditor should identify the different types of assets and determine what steps it needs to take with respect to each type, including the steps to obtain priority (see Section II.A.4 and example 4).

106. A secured creditor should also ask the grantor to provide information on the assets to be encumbered (section 3 of the Sample Diligence Questionnaire). This information can then be used to do the following:

- Confirm the existence and location of the asset;
- Verify whether the grantor has rights in the asset that allows it to grant a security right in the asset;
- Determine the potential value of the asset;
- Determine whether the asset is adequately insured; and
- Determine whether there are any third parties with rights in the asset that may potentially be in competition with the rights of the secured creditor ("competing claimants", ML art. 2(e)).

*[Note to the Commission: While the Working Group had agreed to use the term "competing claims" (A/CN.9/967, para. 51), it is suggested that the term "competing claimants" as defined in the Model Law be used in the Practice Guide, along with the phrase "rights of competing claimants". As the term "competing claimants" is defined broadly, it would cover a broad range of circumstances where another person has a right or a claim in the encumbered asset.]*

#### *Confirm the existence and location of the asset*

107. A secured creditor should confirm that the assets to be encumbered actually exist and where they are located. There are many ways in which this can be done. For example, the existence of inventory and equipment can be confirmed by a physical inspection. To conduct a physical inspection, a secured creditor will first need to ask for information about the location of the asset (sections 2(b) and 3 of the Sample Diligence Questionnaire). In the case of receivables, a secured creditor, with the consent of the grantor, can contact some of the debtors of the receivables to verify the amount owing. In the case of intellectual property registered in specialized registries, a secured creditor can examine the documents on file in the relevant registry to confirm whether the intellectual property rights exist, and to what extent.

108. Unlike present assets, it is not possible to confirm the existence of future assets. A secured creditor may need to take different measures. For example, with respect to future receivables, a secured creditor can review any existing long-term contracts under which receivables might arise in the future or review the past business practice of the grantor to form a view on what future asset may be generated and when.

*Verify whether the grantor can grant a security right in the asset*

109. To create an effective security right in an asset, the grantor must have rights in the asset to be encumbered or the power to encumber it (ML art. 6(1), see Section II.A.1). If the grantor is the owner of the asset, it will be able to grant a security right in it. If the grantor is renting an asset, it will be able to grant a security right in its right to use the asset. A secured creditor should therefore assess whether the grantor has a right for each asset to be encumbered. This is often done as part of the process for confirming existence of the asset to be encumbered. In practice, to reduce cost, a secured creditor will often conduct verification of only some assets of the grantor rather than every asset, particularly when taking security over all assets of the grantor.

110. Depending on the type of asset, a secured creditor can rely on a number of sources to verify that the grantor can grant security over the asset. In the case of equipment or inventory, for example, a secured creditor can examine the purchase orders issued by the grantor to the suppliers as well as the invoices issued by the suppliers. In the case of a bank account, a secured creditor can rely on the name and address of the deposit-taking bank, account information provided by the grantor, and bank statements. In the case of intellectual property registered in a specialized registry, the secured creditor can check whether the grantor is identified as the title holder in that registry. For intellectual property licences, the secured creditor can examine the licence contract.

*Determining the potential value of the asset*

111. There are many ways for a secured creditor to determine the value of the asset to be encumbered. The valuation method will differ depending on the type of asset. For example, if the asset is artwork, a secured creditor will need to first confirm that the work is authentic and then determine its value in the art market. If the asset is inventory, its value will normally be based on prices in the secondary market. If the assets are receivables, their value will usually be based on the amount which the secured creditor would expect to collect from the debtors of the receivables.

112. When determining the value of the asset, a secured creditor should also consider the manner and circumstances in which it might enforce its security right (see Part II.H). If it is likely that a secured creditor would dispose of the asset, its value should be based on prices in the relevant secondary market. A secured creditor should be mindful, however, that it may not be able to recover the current market value as the realisable value may be affected by deteriorating market conditions. Furthermore, when a secured creditor is forced to dispose of the encumbered asset urgently, a buyer will expect to acquire the asset at a substantially lower price.

113. Some valuation methods can be costly relative to the value of the asset. In some cases, it may also be difficult to determine the value of an asset (for example, intellectual property), particularly if it is a type that is not regularly traded.

**Example 14:** Company X sells kitchen appliances to restaurant owners. Restaurant owners are given 60 days to pay for the appliances. Company X does not take security over the kitchen appliances for the unpaid purchase price. While awaiting payment from the restaurant owners, Company X needs money to acquire inventory and to pay operating expenses.

Bank Y provides Company X with a revolving loan, under which Company X can draw down a loan when it needs money to buy inventory or pay other expenses. Bank Y takes security over all of Company X's existing and future inventory and receivables.

114. Example 14 follows the fact pattern of example 10. The amount that Bank Y is prepared to lend under the revolving loan will typically depend on Bank Y's valuation of Company X's inventory and receivables. Bank Y's valuation of the inventory will

take into account the stage in which the assets are in the manufacturing process. Raw materials and finished products are typically more marketable and are valued higher than assets that are only partly complete. Bank Y's valuation of the receivables will take into account the payment history and creditworthiness of the restaurant owners, and whether the receivables owed by any of the restaurant owners represent an uncomfortably high percentage of the receivables as a whole.

*Determine whether the asset is adequately insured*

115. As a security right in an encumbered asset extends to its identifiable proceeds (see Section II.A.12), the secured creditor will have a security right in any insurance proceeds if the encumbered asset is damaged, stolen or destroyed. While there is no requirement in the Model Law that an encumbered asset must be insured, a secured creditor should make sure that the asset is adequately insured against loss or damage, when insurance policies are readily available (section 10 of the Sample Diligence Questionnaire). However, insurance policies may not be readily available for certain types of assets or the cost of insurance for certain types of assets may be quite high.

116. A secured creditor should make sure that the amount for which the encumbered asset is insured is an accurate reflection of the value of the asset. It should also ensure that the terms of the insurance policy provide that any insurance proceeds are to be paid directly to the secured creditor or that the secured creditor is the beneficiary of the insurance policy.

*Determine whether there are any potential competing claimants in the asset and the priority of the security right*

117. As part of due diligence, a secured creditor should examine whether there are any potential competing claimants with a security right or other claim in the asset to be encumbered. The secured creditor should also assess the priority of its security right in relation to the rights of those competing claimants under the priority rules of the Model Law (see Part II.G).

(1) Search the Registry

118. A secured creditor can determine whether there may be competing security rights in the assets to be encumbered by searching the Registry (on how to search, see Part II.C). The Registry will provide information about the potential existence of competing security rights in the assets to be encumbered, and the priority of the security right in relation to competing security rights, which will usually be determined by the first-to-register rule (see Section II.G.1).

119. A secured creditor should also conduct a search of the Registry using the name of any previous owner of the asset to be encumbered (see Section II.C.3).

(2) Determine whether a competing security right has been made effective against third parties by means other than registering a notice in the Registry

120. Even if a search of the Registry does not disclose any prior-registered notices, a secured creditor should check whether any other secured creditor has made its security right effective against third parties by some other method provided in the Model Law.

121. For example, if the asset to be encumbered is a tangible asset, a secured creditor should verify that the grantor is in physical possession of the asset and ensure that the grantor remains in possession until the secured creditor has registered a notice in the Registry. The reason is that obtaining possession is another means by which a secured creditor can make its security right effective against third parties. If another secured creditor took possession of the asset before the registration of the notice, that secured creditor could have priority. If the asset to be encumbered is a bank account, a secured creditor should inquire whether the deposit-taking bank has a security right in the

account, and whether another secured creditor has entered into a control agreement with the deposit-taking bank and the grantor. (see examples 7A and 7B).

122. Some enacting States may require ownership and security rights in certain types of assets to be registered in a specialized registry (ML art. 1(3)(e), see Section II.E.11). If the asset to be encumbered is subject to a specialized registration regime, a secured creditor should conduct a search of the asset-specific registry to check whether there are any competing security rights in the asset (see Section II.C.5).

(3) Determine whether the asset is proceeds of another asset

123. A secured creditor should determine whether the asset to be encumbered is proceeds of another asset and if so, whether that other asset is subject to a security right. This is because a security right in that other asset may extend to the asset as its identifiable proceeds (see Section II.A.12).

(4) Determine the existence of preferential claims and judgment creditors

124. A secured creditor should also determine whether there any competing claimants with preferential claims (sections 8 and 9 of the Sample Diligence Questionnaire, see also Section II.G.5) or judgment creditors (section 6 of the Sample Diligence Questionnaire, see also Section II.G.6), as their existence may have an impact on the priority of its security right.

#### **4. Measures to take when there are competing claimants in the asset, in particular higher-ranking competing claimants**

*Decide to not take the asset as security or to terminate the transaction*

125. If a secured creditor determines that there are competing claimants in the asset to be encumbered, particularly those that will have priority over it (referred to in this Guide as a “higher-ranking” competing claimant), the secured creditor can decide not to take that asset as security, or perhaps not to proceed with the transaction at all.

*Other measures*

126. Depending on the circumstances, there are also some other measures that a secured creditor can take as a response:

- The secured creditor can change the terms of the loan agreement to reflect the additional risk (for example, by reducing the amount of the loan or increasing the interest rate).
- The secured creditor can ask the grantor to provide a different asset as security.
- If there is a higher-ranking security creditor, the secured creditor can ask the grantor to have the higher-ranking security right extinguished by discharging the obligations that it secures (ML art. 12, see Part II.G bis). Once the security right is extinguished, the secured creditor can require the grantor to request the higher-ranking secured creditor to register a cancellation notice (see Section II.E.10).
- If there is a higher-ranking security right and the loan obtained by the grantor will be used to discharge the obligation that the higher-ranking security right secures, the secured creditor can verify the obligation (for example, the amount that is still owed to the higher-ranking secured creditor) and ensure that the appropriate amount is paid from the loan directly to the higher-ranking secured creditor. This would usually extinguish the higher-ranking security right. Then secured creditor can then require the grantor to request the higher-ranking secured creditor to register a cancellation notice.
- The secured creditor can ask the higher-ranking secured creditor to subordinate the priority of its security right unilaterally or by entering into a subordination agreement.

- If the description of the assets in the security agreement with the higher-ranking secured creditor was too broad and should not have included the asset to be encumbered, the secured creditor can ask the grantor to have the security agreement with the higher-ranking secured creditor amended to release the asset. In this situation, the secured creditor can also require the grantor to request the higher-ranking secured creditor to register an amendment notice to reflect this change (See Section II.E.10).
- If the asset to be encumbered was described in the registered notice but not in the security agreement, the secured creditor can require the grantor to request the higher-ranking secured creditor to register an amendment notice to remove the assets from the registered notice (See Section II.E.10).

*Determine the residual value of the asset after discharging obligations secured by higher-ranking secured creditors and other claims*

127. Even if it is determined that there are higher-ranking competing claimants in the asset to be encumbered, a secured creditor may still be prepared to take security over the asset. In that case, a secured creditor will need to assess the residual value of the asset after it is used to satisfy the obligations secured by the higher-ranking security right and any other higher-ranking claims.

128. If an enacting State requires that the maximum amount for which a security right can be enforced must be set out in the security agreement (ML art. 6(3)(d)) and accordingly in the notice (MRP art. 8(e)), it will be easier for a subsequent creditor to assess the residual value of the asset after satisfying the obligations secured by the higher-ranking security right. In States that do not have these requirements, a subsequent creditor can manage its risk with regard to the residual value by obtaining an undertaking from the higher-ranking secured creditor that limits its priority to a specified amount.

## **C. Searching the Registry**

### **1. General**

129. Part II.B highlights the importance of searching the Registry, and what can be done if a search shows that there are competing security rights in the assets described in a notice. Under the Model Law, anyone can search the Registry as long as they use the prescribed search request form and pay the prescribed fees (MRP art. 5(3)).

### **2. Who should search the Registry, why and when**

130. The most usual way of making a security right effective against third parties is to register a notice in the Registry (ML art. 18(1), see Part II.E). A search of the Registry can therefore reveal the potential existence of a security right in an asset. For this reason, any person who might be adversely affected by a security right in an asset should search the Registry to check whether there are any notices that describe that asset. This section lists the persons that should search the Registry and explains why and when they should do so.

*A potential secured creditor*

131. A creditor that wants to take a security right in an asset should search the Registry at an early stage of its negotiations with the grantor. The search will allow the creditor to determine whether another secured creditor has already registered a notice relating to the asset to be encumbered.

132. The registration of a notice is effective only when the information in the notice is publicly searchable (MRP art. 13). For this reason, a secured creditor should conduct a second search of the Registry immediately after it registers its notice to

check that the notice is searchable and that no other notice has been registered since it conducted the first search. If the second search confirms that no notice has been registered since the first search, the secured creditor can disburse funds to the grantor without worrying that another creditor might have obtained a higher-ranking security right by registering ahead of it.

133. However, a secured creditor should be cautious in disbursing funds if the asset was acquired recently by the grantor. This also applies to a secured creditor that has taken a security right in the grantor's future assets, registered a notice in the Registry and is planning to disburse funds based on a new asset acquired by the grantor. The reason being that an acquisition secured creditor can obtain priority over a prior-registered secured creditor, if the acquisition secured creditor registers a notice before the expiry of a short time period specified by the enacting State (ML art. 38, see Section II.G.3). If the secured creditor wants to be sure that there is no higher-ranking acquisition secured creditor in relation to the newly-acquired asset, it needs to conduct a third search after the expiry of that short time period to check whether any notice has been registered in relation to that asset.

134. In enacting States that choose option A of article 38 of the Model Law, a secured creditor does not need to conduct this third search if the asset acquired by the grantor is inventory or its intellectual property equivalent. The reason is that an acquisition secured creditor is required to notify prior-registered secured creditors of its intention to take an acquisition security right in those type of asset (ML art. 38, option A, para. 2).

#### *A potential buyer or other transferee*

135. A person that wants to buy an asset from another person will usually not need to conduct a search of the Registry, particularly when the seller is in the business of selling such type of assets. This is because a tangible asset bought in the ordinary course of business of the seller will not be subject to any security right in that asset (ML art. 34(4)). This also applies to a tangible asset that the lessee leases from a lessor who is in the business of leasing such type of assets (ML art. 34(5)).

136. However, a buyer or a lessee that purchases or leases a tangible asset from a seller or a lessor that is not in the business of selling or leasing such type of assets should search the Registry to check whether the asset may be subject to a security right. This is because the rights of the buyer or the lessee may be subject to any pre-existing security right in the asset (ML art. 34(1)). If a search of the Registry reveals a notice relating to the asset, the buyer or the lessee should make further inquiries with the seller or the lessor. Similar to measures to be taken by a potential secured creditor when there are competing claimants in the asset (see Section II.B.4), the buyer or the lessee should terminate the transaction or ask the seller or the lessor to have the security right extinguished before entering into the transaction.

#### *Judgment creditors, insolvency representatives and others*

137. A judgment creditor should search the Registry to identify assets of the judgment debtor that are not subject to a security right. While it may be possible to acquire rights in an encumbered asset, it would be easier and more effective to execute a judgment against an unencumbered asset (ML art. 37, see Section II.G.6 and example 26). An insolvency representative should search the Registry to see if any notice has been registered, as it can help the insolvency representative to further investigate what obligations are owed by the grantor and their outstanding amount.

138. An unsecured creditor should search the Registry as part of its general risk assessment of the debtor or to determine whether there is any merit in obtaining a judgment and pursuing execution against the assets of the debtor. Credit rating agencies often search the Registry as part of their assessment processes.

### **3. How to search the Registry**

#### *Search criteria*

139. A search of the Registry should always be conducted using the name of the grantor. A secured creditor will often also search using the names of the debtor (if different to the grantor) and any other guarantors as part of its overall assessment of the debtor's creditworthiness.

#### *How to determine the correct name for searching*

140. A searcher should use the correct name of the grantor when it searches the Registry. A searcher should check before using a business or trade name, as that name may not be the correct name to use for the search. The enacting State will have specified which official documents or public records can be used to determine the correct name (MRP art. 9). Depending on the rules specified by the enacting State, this may be a national identity card, birth certificate or driver's licence for individuals and a public corporate or business register for legal entities. A searcher may need to obtain a copy of the specified official document or search the relevant public records.

141. Individuals may be hesitant to provide a copy of their official documents to some searchers (for example, a creditor seeking to obtain a judgment). In such a case, a searcher will need to search against all likely names of the individual.

#### *Exact or close match search results*

142. In enacting States that opt for an "exact match" system, a search of the Registry will only reveal notices in which the name of the grantor exactly matches the name entered by the searcher (MRP art. 23, option A). In enacting States that opt for a "close match" system, a search will disclose not only exact matches, but also notices in which the name of the grantor closely matches the name entered by the searcher (MRP art. 23, option B). What is or is not a "close match" will depend on the algorithms used for this purpose in the enacting State's Registry software. Accordingly, even in enacting States that provide close match results, a searcher should use the correct name of the grantor when conducting the search to ensure that it obtains a reliable search result.

143. Regardless of the option chosen by the enacting State, a searcher will need to determine whether the notices disclosed in the search result do in fact relate to the relevant person and whether any of the notices includes a description of the relevant asset.

#### *Unauthorized notices*

144. A search of the Registry may disclose an initial notice that has not been authorized by the grantor, or an amendment or cancellation notice that has not been authorized by the secured creditor. A searcher should fully understand the possible consequences of such unauthorized registration (see, respectively, Sections II.E.4 and II.E.11).

### **4. Situations where a search using a single name may not be sufficient**

#### *Where the grantor changed its name*

145. If the grantor changes its name after a notice has been registered, a search of the Registry using the grantor's new name will not disclose that notice. For this reason, a searcher should ascertain whether the grantor previously had a different name (section 1 of the Sample Diligence Questionnaire). If the grantor is a legal entity, a searcher will usually be able to conduct a search of the public records to check if any other name(s) had been used in the past.

146. If the grantor has recently changed its name, a searcher should search using not only the grantor's present name but also its prior name. The reason being that a secured creditor who registered a notice using the prior name can retain the priority of its security right by registering an amendment notice adding the new name of the grantor before the expiry of the time period specified by the enacting State (MRP art. 25, see Section E.7 and example 17). A search using the prior name of the grantor will disclose competing secured creditors that could have priority by registering an amendment notice. A searcher would not need to conduct a search using the prior name of the grantor, however, if the time period specified by the enacting State has expired.

*Where an asset was purchased from a person outside its ordinary course of business*

**Example 15:** Company V is in the business of printing daily newspapers. Bank Y provides Company V with a loan and takes security over Company V's printing press to secure the loan. Bank Y registers a notice in the Registry. The next month, Company V sells the printing press to Company W, also in the business of printing daily newspapers. Company V and W are not in the business of selling printing presses and the sale of the printing press is outside the ordinary course of their business.

**Example 15A:** Company W wants to sell the printing press to Company X.

**Example 15B:** Company W wants to obtain a loan from Bank Z that is secured by a security right in the printing press.

<For ease of reference, the printing press is being transferred from Company V to W to X. Bank Y and Z are secured creditors. >

147. Under the Model Law, a buyer of an encumbered asset will generally acquire the asset subject to the security right, if the security right had been made effective against third parties before the sale (ML art. 34(1), see Section II.G.2 for exceptions to this general rule). In example 15, Company W acquires the printing press subject to the security right that Company V granted to Bank Y.

148. Before entering into a transaction, a prospective buyer (Company X in example 15A) should determine whether the seller (Company W) is the original owner of the asset, as the seller may have acquired the asset subject to a security right that had been granted by a previous owner. When Company X finds out that Company W had purchased the printing press from Company V, Company X should search the Registry not only using the name of Company W but also the name of Company V. This search will disclose the notice registered by Bank Y and alert them that the printing press may be subject to Bank Y's security right.

149. The same applies to a prospective secured creditor (Bank Z in example 15B). When Bank Z finds out that Company W had purchased the printing press from Company V, Bank Z should search the Registry not only using the name of Company W, but also the name of Company V.

150. In enacting States that require a secured creditor to register an amendment notice adding the name of the buyer as a new grantor when an encumbered asset is transferred (MRP art. 26, option A, see Section II.E.8 and example 19), Company X and Bank Z might not need to conduct a search of the Registry using the name of Company V if the time period specified by the enacting State to register the amendment notice has expired. This is because a security right created by the previous owner (Company V) is no longer effective against third parties after that period unless the amendment notice is registered.

## 5. Searches in other registries

151. Under the Model Law, the Registry is the place to register notices relating to security rights in most types of movable assets (ML arts.1(1)-(2)). However, some

enacting States may require rights in certain types of assets to be registered in a separate asset-specific registry (ML art. 1(3)(e), see Section II.E.11). If the asset to be encumbered or purchased is subject to a specialized registration regime, a searcher will need to search the relevant registry in addition to the Registry.

## **D. Preparing the security agreement**

### **1. General**

152. Once the terms of the secured transaction have been agreed upon and the secured creditor has conducted its due diligence, the parties will need to prepare an agreement that creates a security right in the relevant assets of the grantor in favour of the secured creditor. Such an agreement is referred to as a “security agreement” in the Model Law regardless of how the parties have denominated it (ML art. 2(jj)).

153. A contract under which goods are sold on retention-of-title terms and a financial lease agreement are just two examples of a security agreement (see Section II.A.5 and examples 5A to 5D). An agreement for the transfer of a receivable is also regarded as a security agreement under the Model Law, as it applies to outright transfers of receivables (see Section II.A.9 and example 9).

154. Two samples of a security agreement, which cover assets owned by the grantor can be found in Annex IV (“Sample Security Agreements A and B”). Sample retention-of-title clauses can be found in Annex V.

### **2. Requirements for a security agreement**

#### *Form requirements - In writing and signed by the grantor*

155. As illustrated throughout Part A of this Chapter, a security agreement needs to be in writing and signed by the grantor. “Writing” includes electronic communications (ML art. 2 (nn)) meaning that an agreement entered into via e-mail using an electronic signature will meet the requirements.

156. As an exception to the “writing” requirement, a security agreement may be oral if the secured creditor is in possession of the encumbered asset. However, parties should still document their agreement in writing to avoid disputes as to the exact terms of their arrangement and for evidentiary purposes.

#### *Minimum content of the security agreement*

157. The Model Law prescribes very few requirements with regard to the content of a security agreement. The security agreement must identify the parties (the secured creditor and the grantor), describe the secured obligation, and describe the assets to be encumbered (ML art. 6(3)).

#### *How to describe the secured obligation*

158. The secured obligation should be described in a manner that reasonably allows it to be identified (ML art. 9(1)). A security right can secure specific existing or future obligations (or both), or all obligations owed to the secured creditor at any time. If the security agreement secures all obligations owed to the secured creditor at any time, then a description using those terms is sufficient (ML art. 9(3), see section 2.2 of Sample Security Agreement B).

#### *How to describe the encumbered asset*

159. The encumbered asset should be described in the security agreement in a manner that reasonably allows it to be identified (ML art. 9(1)). The same applies when registering a notice (MRP art. 11, see Section II.E.5). If the encumbered asset is a specific item, a detailed description can be provided (for example, “printing press

manufactured by Company A, bearing Serial Number 1234XYZ”). However, a less-detailed description is enough if it would still enable the encumbered asset to be reasonably identified. For example, a description such as “printing press” is sufficient if the grantor owns only one printing press. However, if the grantor owns more than one printing press, and the security agreement intends to cover only one or some of them, a more detailed description is necessary to identify which of the printing presses may be encumbered.

160. If the encumbered assets fall within a generic category, the description in the security agreement only needs to refer to that generic category, for example, “all present and after-acquired inventory.” Similarly, if the security right is intended to cover all the grantor’s present and future movable assets, then the assets can be described using those words (ML art. 9(3)).

161. Generic descriptions can be combined with more detailed descriptions if the parties want to exclude some assets from a generic category of encumbered assets (for example, “all present and future receivables owing to the grantor, except receivables owed by X”, or “all present and future assets, except inventory manufactured by X”).

#### *Maximum amount for enforcement*

162. Enacting States may require that a security agreement state the maximum amount for which the security right can be enforced (ML art. 6(3)(d)) and that the same information be included in the notice (MRP art. 8(e), see Section II.E.5). This requirement is useful in situations where the value of the encumbered asset significantly exceeds the amount of the obligation secured by that asset. The objective is to make it easier for a grantor to use the residual value of the encumbered asset to obtain financing from other creditors. In setting the maximum amount, a secured creditor should bear in mind the amount that it may be owed, including unpaid interest and the enforcement costs.

**Example 16:** Company X runs five pizza restaurants. Bank Y makes a loan of \$10,000 to Company X. Company X gives Bank Y a security right in its five pizza ovens as security for the loan. In total, the ovens are valued at \$30,000. State A requires that the security agreement state the maximum amount for which Bank Y can enforce its security right and requires that this amount be also stated in the notice. Bank Y registers a notice stating that the maximum amount is \$12,000. This is the same maximum amount stated in the security agreement.

163. In example 16, Bank Y is secured by its security right in the pizza ovens for up to \$12,000. But it is unsecured for anything beyond that amount. Bank Y will want to be confident that the maximum amount stated in the security agreement is enough to cover all credit that it intends to extend to Company X (\$10,000) as well as any unpaid interest and potential enforcement costs. In this example, \$2,000 was considered to be sufficient to cover all possible additional amounts.

164. Because Bank Y’s security right can be enforced up to a maximum of only \$12,000, a subsequent creditor may be willing to extend credit to Company X secured by the ovens up to their estimated market value less the amount stated in the notice registered by Bank Y (in other words, \$18,000). The subsequent creditor would need to also consider anticipated unpaid interest and enforcement costs.

### **3. Other provisions that can be included in a security agreement**

#### *Variations in the structure and content of a security agreement – party autonomy*

165. The structure of a security agreement will vary greatly, depending on the nature of the transaction and the parties’ commercial needs. A security agreement will be very short if it includes only the minimum content required by Model Law (see Sample Security Agreement A). However, the parties will usually include other

provisions that set out more detailed terms of their agreement (see Sample Security Agreement B, which involves a more complicated transaction where a secured creditor is providing a line of credit and takes security over all of grantor's present and future assets).

166. The secured creditor and the grantor are generally free to agree on the content of their security agreement (this freedom is referred to as "party autonomy", ML art. 3 (1)). They can include terms that are suitable to their needs and for the particular transaction. For example, the security agreement may include terms on the monitoring of the encumbered assets, on the resolutions of disputes arising out of the transaction, on events of default and on measures a secured creditor can take to enforce its security right (see sections 1 and 3 to 6 of the Sample Security Agreement B).

#### *Limitations on the autonomy of the parties*

167. While the parties are given substantial freedom to structure their agreement as they see fit, there are certain limitations (ML art. 3(1)). For example, the parties are obliged to act in good faith and in a commercially reasonable manner (ML art. 4) and the parties cannot agree that this does not apply to their transaction. Nor can they agree that the secured creditor can retain possession of the encumbered assets for a certain period after the security right is extinguished (ML art. 54). A grantor cannot waive by agreement any of its rights under the enforcement provisions of the Model Law before default (ML art. 72(3)). Also, the terms of a security agreement cannot affect the rights or obligations of a person that is not a party to the agreement (ML art. 3(2)). Parties should also be mindful that there may be other laws that limit the scope of their autonomy (ML art. 1(4) and 1(5), for example, laws that limit a secured creditor's ability to accelerate repayment of a loan on default).

*[Note to the Commission: The Commission may wish to consider whether the examples of limitations set out in paragraph 167 are appropriate and whether they should all be retained.]*

#### *Events of default*

168. Default occurs when the debtor fails to pay or otherwise perform the secured obligation (ML art. 2(j)). A secured creditor and a grantor can agree that other events also constitute a default, which is usually reflected in the security agreement. Following are some events that typically constitute default in a security agreement:

- The failure by the grantor to pay when due any amount owing;
- The insolvency of the grantor;
- A third party taking steps to seize or enforce against any of the encumbered asset;
- The entry of a judgment against the grantor above a specified amount;
- A representation made by the grantor in the security agreement (or in any document delivered to the secured creditor pursuant to the agreement) being false or misleading in any material respect; and
- Any material non-performance by the grantor of any of its other obligations under the agreement.

169. Where the grantor is not the debtor of the secured obligations, the events of default should also include the debtor to the extent applicable. Some of these events will only become an event of default if the circumstances are not remedied within a time period agreed by the parties.

170. Where a security agreement is entered into to secure an obligation that arises under a separate agreement (for example, a loan agreement), the events of default will

likely be set out in that separate agreement. In that case, the security agreement will include a cross-reference to that relevant provision.

#### *Retention-of-title clause*

171. The sample retention-of-title clauses in annex V are quite different in structure from the sample security agreements in Annex IV. The sample retention-of-title clauses are suitable for use in a sale contract where the seller wants to retain title to the assets until the buyer makes full payment of the purchase price (see example 5A). While the parties can enter into a stand-alone retention-of-title agreement, it is more likely that they would include these clauses in the sale contract itself. The precise terms will need to be adjusted to reflect the particular circumstances, depending for example on whether the assets are to be used as equipment, as inventory for resale or in a manufacturing process. The sample retention-of-title clauses deal with a situation where the asset is not intended for resale.

## **E. Registering a notice in the Registry**

172. As highlighted throughout this Guide, the most usual way to make a security right effective against third parties is to register a notice in the Registry (ML art. 18). This Part provides guidance on who should register a notice, and when and how to register.

173. There are three types of notices under the Model Law: an initial notice, an amendment notice, and a cancellation notice. This Part focuses mostly on registering an initial notice. It also discusses the circumstances where the secured creditor should or must register an amendment or cancellation notice as well as the obligations of the secured creditor during the registration process. Lastly, this Part explains the consequences when an amendment or cancellation notice is registered without the authorization of the secured creditor.

### **1. Who should register?**

174. Registration of a notice is relevant to all types of secured creditors. This includes not only a secured creditor that is a lender but also:

- A seller of goods on retention-of-title terms
- A lessor under a financial lease; and
- An outright transferee of a receivable (see examples 5A to 5D and 9).

175. In practice, it is the secured creditor that submits a notice in the Registry, even though anyone can submit a notice under the Model Law (MRP art. 5(1)). A secured creditor can delegate the task of registration to another person, such as its lawyer or a registration service provider. Whether the secured creditor registers the notice itself or uses the services of another person, the secured creditor will suffer the consequences if an error or omission makes the registration ineffective. For this reason, a secured creditor should always check to ensure that the registration was done correctly by conducting a follow-up search of the Registry (see Section II.C.1). If a secured creditor decides to delegate the task of registration, it should make sure that it has remedy if the registration is not made correctly (for example, by including an indemnity clause in the service agreement and ensuring that the service provider is insured against liability for its errors).

### **2. When to register an initial notice?**

176. An initial notice can be registered at any time. This can be done even before the security agreement is entered into (MRP art. 4). This is referred to as “advance registration” under the Model Law. A secured creditor should consider registering at an early stage of the negotiations with the grantor (for example, as soon as the basic

terms of the financing arrangement are agreed upon), because priority between competing security rights in the same asset is generally determined by the order in which the initial notices are registered (see Section II.G.1).

177. A secured creditor should be aware that advance registration may not be sufficient to protect its security right as against competing claimants. For example, if the person identified as the grantor in an advance registration sells the asset described in the notice before the security agreement is entered into, the buyer will acquire the asset free of the security right. Similarly, if insolvency proceedings are commenced in respect of the person identified as the grantor before the security agreement is entered into, the security right once created will be ineffective against the insolvency representative.

### **3. How to register an initial notice?**

178. The registration process is straightforward. To register an initial notice, the secured creditor only needs to do the following (MRP art. 5(1)).

- Submit the notice to the Registry in the prescribed form;
- Provide evidence of its identity in the prescribed manner; and
- Pay the required fee (if any).

179. The requirements for registering an amendment or cancellation notice are the same, except that the secured creditor also needs to satisfy the secure access requirements set by the Registry (MRP art. 5(2)).

180. A registration is effective as soon as the information contained in the notice is publicly searchable (MRP art. 13(1)). In most enacting States, the Registry will be electronic, meaning that both registrations and searches can be done directly through the Internet or via a direct network system. A secured creditor will usually be able to conduct a search to verify that the information in the notice is publicly searchable almost immediately after it submits the notice.

181. If available, a secured creditor should follow the guidelines provided by the Registry regarding the registration process. These guidelines typically explain the following:

- How to set up and operate user accounts;
- Access protocols for registering and searching (including access IDs or other credentials); and
- Secure access requirements for registering amendment and cancellation notices.

### **4. Obtaining the grantor's authorization**

182. The registration of an initial notice is effective only if the grantor authorized it in writing (MRP art. 2(1)). The grantor does not need to give the authorization before the registration and can give it later instead (MRP art. 2(4)). If a security agreement is entered into between the parties after the registration, that constitutes authorization for any previously-registered notices with respect to the assets that are described in the security agreement (MRP art. 2(5)).

183. The registration of an amendment notice that adds a grantor or adds encumbered assets also requires the grantor's authorization (MRP art. 2(2) and (3)).

184. While the grantor's authorization is required for the registration to be effective, it is not a formal step in the registration process and the Registry cannot require the secured creditor to show that the grantor authorised a proposed registration (MRP art. 2(6)).

185. A template of a grantor's authorization is contained in Annex VI.

## 5. What information is required in an initial notice?

186. The following information needs to be included in an initial notice (MRP art. 8):

- The name and address of the grantor;
- The name and address of the secured creditor; and
- A description of the encumbered assets.

187. Depending on the options chosen by the enacting State, an initial notice may also need to indicate:

- the period of effectiveness of the registration (MRP arts. 8(d) and 14, options B and C); and
- the maximum amount for which the security right may be enforced (ML art. 6(3)(d) and MRP art. 8(e)).

### *Name and address of the grantor*

188. When registering a notice, a secured creditor should enter the correct name of the grantor. This is because a registration will be ineffective if a search using the correct name does not retrieve the notice (MRP arts. 24(1) and (2)).

189. The enacting State will have specified the official documents or public records that can be used to determine the correct name of the grantor (MRP art. 9). Depending on the rules specified by the enacting State, this may be a national identity card, birth certificate or driver's licence for individuals and a public corporate or business register for legal entities. A secured creditor may need to obtain a copy of the specified official document or search the relevant public records.

190. The secured creditor should also enter the accurate address of the grantor, which can be used by searchers to contact the grantor, for example, to inquire about whether a security agreement has been entered into. Entering the grantor's accurate address is also useful if a search retrieves notices relating to multiple grantors with the same name. The addresses can assist the searcher in determining whether any of the notices relate to the grantor in which it is interested.

### *Name and address of the secured creditor or its representative*

191. The secured creditor needs to enter its name and address in the initial notice. Alternatively, it can enter the name and address of its representative. This is useful in situations, for example, where the financing is provided by a group or syndicate of lenders. In that case, the initial notice can indicate the name and address of the administrative agent or other representative of the syndicate as opposed to having to include the names and addresses of all participating lenders.

192. The enacting State will have specified the official documents or public records that can be used to determine the correct name of the secured creditor or its representative. Typically, they will be the same as for determining the correct name of the grantor (MRP art. 10).

193. Unlike the name of the grantor, the name of the secured creditor or its representative is not a search criterion (MRP art. 22). This means that an error in the name of the secured creditor or its representative will generally not make a registration ineffective (MRP art. 24(4)). It is nevertheless important for the secured creditor to enter its correct name and accurate address, as this information can be used by third parties to send notices and other communications to the secured creditor. This includes, for example, a subsequent secured creditor that it intends to obtain an acquisition security right (ML art. 38, option A, para. 2) and a competing secured creditor that intends to enforce its security right (ML arts. 78(4) and 80(2)).

*Description of the encumbered assets*

194. An initial notice needs to describe the encumbered assets in a way that reasonably enables them to be identified (MRP art. 11(1)). This requirement is intended to ensure that searchers can determine which assets of the grantor may be subject to a security right.

195. If the encumbered asset is a specific item, a detailed description can be provided (for example, “printing press manufactured by Company A, bearing Serial Number 1234XYZ”). However, a less-detailed description is enough if it would still enable the encumbered asset to be reasonably identified. For example, a description such as “printing press” is enough if the grantor owns only one printing press. However, if the grantor owns more than one printing press, and the notice intends to cover only one or some of them, a more detailed description is necessary to identify which of the printing presses may be encumbered.

196. If the encumbered assets fall within a generic category, the description in the notice only needs to refer to that generic category, for example, “all present and after-acquired inventory.” Similarly, if the security right is intended to cover all the grantor’s present and future movable assets, then the assets can be described using those words (MRP art. 11(2)).

197. Generic descriptions can be combined with more detailed descriptions if the parties want to exclude some assets from a generic category of encumbered assets (for example, “all present and future receivables owing to the grantor, except receivables owed by X”, or “all present and future assets, except inventory manufactured by X”).

198. A secured creditor should avoid describing the encumbered assets in a way that might require it to register an amendment notice because of events that could happen after the registration. For example, a notice should avoid describing assets by their location (“all equipment located at 123 Street, ABC City”) unless the secured creditor is confident that the assets will remain at that location for the duration of the financing.

199. A secured creditor and a grantor may intend to enter into more than one security agreement, such as a series of agreements to finance the grantor’s acquisition of several delivery vans over time. In that case, the secured creditor can register a single notice to cover the security rights created under all the agreements, including agreements that will be entered into at a later stage (MRP art. 3). The secured creditor does not need to register a separate notice for each security agreement as long as the description of the encumbered assets in the single initial notice is broad enough to cover the assets to be encumbered by all the agreements. For example, if the secured creditor registers an initial notice that describes the encumbered assets as “all present and future delivery vans of the grantor”, it will not need to register a separate initial notice for any of the subsequent security agreements.

200. In some enacting States, the Registry may be designed to make it possible to attach files describing the encumbered assets, such as documents or photos. In that case, a secured creditor could attach a photo of the encumbered asset to the initial notice. If the photo or other attachment reasonably allows the identification of the encumbered asset, the secured creditor will not need to also include a narrative description of the encumbered asset in the notice.

*Period of effectiveness of the registration*

201. A secured creditor may need to indicate in the initial notice how long the registration will be effective. Whether it must do this depends on the option that the enacting State has chosen with regard to the period of effectiveness of a registration (MRP art. 14). Regardless of the option chosen, the period of effectiveness of a registration can be extended more than once (MRP art. 14(3)).

<p>Option A: The enacting State fixes the period of effectiveness, for example, 5 years.</p>	<p>A secured creditor does not need to indicate the period of effectiveness in the initial notice. It is effective for 5 years.</p> <p>The secured creditor can extend the registration for another 5 years by registering an amendment notice.</p> <p>The amendment notice can only be registered within a time period (specified by the enacting State) before the registration expires.</p> <p>The secured creditor should put in place a system that will remind it to do this within that time period.</p>
<p>Option B: The enacting State allows the secured creditor to determine the period of effectiveness.</p>	<p>A secured creditor needs to indicate the period of effectiveness in the initial notice.</p> <p>The secured creditor can extend the registration at any time before it expires by registering an amendment notice.</p> <p>A secured creditor can reduce the need to register amendment notices to extend the registration by specifying in the initial notice a period that reflects the expected duration of the financing, including time that might be needed for enforcement after default.</p>
<p>Option C: The enacting State allows the secured creditor to determine the period of effectiveness but puts a cap on the maximum period, for example 5 years.</p>	<p>A secured creditor needs to indicate the period of effectiveness in the initial notice, but the registration is only effective for up to 5 years.</p> <p>If 5 years is shorter than the expected duration of the financing (including any time that might be needed for enforcement after default), a secured creditor should extend the registration before it expires by registering an amendment notice.</p> <p>As an amendment notice can be registered only within a time period (specified by the enacting State) before the registration expires. The secured creditor should put in place a system that will remind it to do this within that time period.</p>

*Statement of the maximum amount for which the security right may be enforced*

202. A secured creditor may need to state in the initial notice the maximum amount for which its security right can be enforced (MRP art. 8(e)). Whether it must do this depends on whether the enacting State requires the maximum amount to be stated in the security agreement (ML art. 6(3)(d), see Section II.D.2 and example 16).

*Secured obligation need not be described*

203. While the secured obligation needs to be described in the security agreement (see Section II.D.2), it does not need to be described in the initial notice. A secured creditor should ensure that the notice does not include this or any other information that it wants to remain confidential.

**6. Obligation to send a copy of a registered notice to the grantor**

204. After a secured creditor submits a notice, it will receive a copy of the information in the registered notice from the Registry. This will include the date and time the notice became accessible to searchers and the registration number assigned to it by the Registry (MRP art. 15(1)).

205. When it receives the copy of the information from the Registry, the secured creditor must send the copy to the grantor within a time period specified by the enacting State (MRP art. 15(2)). A failure to comply with this obligation does not affect the effectiveness of the registration (MRP art. 15(3)), but the secured creditor will be liable to pay the grantor a nominal amount of money as specified by the enacting State and any actual loss or damage that the grantor suffered as a result of the secured creditor's failure (MRP art. 15(4)).

206. When it receives the copy of the information from the secured creditor, the grantor can determine whether the description of the encumbered assets correctly reflects the its agreement with the secured creditor. If it does not, the grantor can ask the secured creditor to register an amendment or cancellation notice to correct this (see Section II.E.10).

**7. Who can register an amendment notice?**

207. Information in a registered notice can be modified by submitting an amendment notice. The only person allowed to register an amendment notice is the person identified in the registration as the secured creditor (MRP art. 16(1)). If an amendment notice is registered to change the secured creditor, only the new secured creditor is allowed to register any subsequent amendment notices (MRP art. 16(2)).

208. The consequences of an amendment or cancellation notice that is registered without the authorization of the secured creditor are discussed in section 11 below.

**8. When and how to register an amendment notice**

209. This section discusses the most common circumstances in which a secured creditor should register an amendment notice.

*The registered notice contains an error or is incomplete*

210. After a notice is registered, the secured creditor will receive a copy of the information in the registered notice from the Registry (see Section II.E.6). The secured creditor should immediately check whether that information is accurate and complete, and register an amendment notice if there are any errors or omissions.

211. Like an initial notice, an amendment notice is effective only from the time the information in the notice is publicly searchable (MRP art. 13(1)). This means that a secured creditor should register its amendment notice promptly.

*The grantor changes its name*

212. The grantor's name may change after an initial notice is registered. For example, an individual may change its name legally, or a company may merge with another company and its name could change as a result. To preserve its priority against subsequent competing secured creditors or buyers of the encumbered asset, the secured creditor needs to register an amendment notice that adds the new name of the grantor before the expiry of the time period specified by the enacting State

(MRP art. 25). Otherwise, its security right may not have priority over the security right of a subsequent secured creditor that registered a notice using the grantor's new name. Similarly, its security right may not be effective against a subsequent buyer of the encumbered asset if that buyer purchased the asset from the grantor after the grantor changed its name.

**Example 17:** John Smith grants Bank Y a security right over his tractor. Bank Y registers an initial notice in the Registry on 18 March identifying John Smith as the grantor. Afterwards, John applies to court to change his first name to Robert. The application is approved and takes effect on 18 June. The enacting State has specified a time period of 90 days for the secured creditor to register an amendment notice to reflect a change in the name of the grantor.

**Example 17A:** On 1 August, Robert obtains a loan from Bank Z and grants Bank Z a security right over the same tractor. Bank Z registers a notice on the same day identifying Robert Smith as the grantor.

**Example 17B:** On 1 August, Robert sells the tractor to Buyer Z.

213. In example 17A, Bank Y can preserve its priority against Bank Z by registering an amendment notice that identifies Robert Smith as an additional grantor within 90 days of the name change. If Bank Y does the same in example 17B, its security right will be effective against Buyer Z.

214. Bank Y can also register an amendment notice after the expiry of the 90-day period. In this case, however, its priority will not be preserved against Bank Z in example 17A. And Buyer Z will acquire the tractor free of the security right in example 17B.

215. The 90-day period in example 17 is intended to provide the secured creditor (Bank Y) with a reasonable period to find out about the change in the name of the grantor and to register an amendment notice within that period. To protect itself against the priority risk posed by a change in the grantor's name, a secured creditor should periodically check whether the grantor has changed its name as part of its ongoing monitoring of the grantor (see Section II.F.2).

*The secured creditor changes its name or address*

216. A secured creditor may change its name or address (or both) after it registers an initial notice. Unlike a change in the name of the grantor, these types of change do not affect the effectiveness of the registration in any way. Nonetheless, a secured creditor should update registrations in which it is identified as the secured creditor to reflect the change(s). This will ensure that the secured creditor continues to receive any notices or other communications that are sent by third parties to it using its name and address in the registration.

217. A secured creditor can update its name and address by registering separate amendment notices for each registration in which it is identified as the secured creditor. This could be burdensome, however, if there are many such registrations. In this situation, the secured creditor can arrange for a single "global" amendment to modify its information in all the registrations (MRP art.18). Depending on the option chosen by the enacting State, a secured creditor can either register a single amendment notice for this purpose (MRP art. 18, option A) or request the Registry to amend the information (MRP art. 18, option B).

*The secured creditor transfers the security right*

218. A secured creditor may transfer its security right to a new secured creditor after it registers an initial notice. In this case, the new secured creditor should ensure that an amendment notice is registered that identifies itself as the secured creditor in the registration. To do this, the new secured creditor needs to request the previous secured creditor to register an amendment notice that replaces its name in the registration with

the name of the new secured creditor. The registration of an amendment notice to reflect the transfer of a security right is not required to preserve the third-party effectiveness of the security right. However, it is in the interests of the new secured creditor, as it will ensure that any notices or other communications sent by third parties using the name and address of the secured creditor in the registration will come to it rather than to the previous secured creditor.

219. The new secured creditor should also ask the Registry to provide it with new secure access codes or other credentials for the registration, and to cancel the secured access code or other credentials that were provided to the previous secured creditor. This will remove the risk that the previous secured creditor could continue to make changes to the registration.

*The secured creditor wants to add a description of other assets or change the description of the assets*

220. A secured creditor may want to add a description of other assets to the registration. For example, the secured creditor might discover that the description in the initial notice was too narrow and did not cover all the assets that were intended to be subject to the security agreement. Alternatively, the grantor might later agree to provide additional assets as security. In these circumstances, the secured creditor should register an amendment notice that describes the additional assets. As an alternative, the secured creditor could register a new initial notice that covers the additional assets.

221. The same applies if the secured creditor wants to change the description of the assets already in the registration. This may be necessary when a secured creditor realizes that the current description in the registration does not reasonably identify the asset, or when it has agreed with the grantor to release some of the assets but instead obtain a security right in other assets.

222. Any change to the description of the encumbered asset in a registration only becomes effective when the information in the amendment notice is publicly searchable (MRP art. 13(1)). This means that the security right in the assets that are newly described is likely to be subordinate to any competing security right for which a notice was registered before the amendment notice.

*The grantor has disposed of the encumbered asset and the secured creditor needs to add a description of the proceeds*

**Example 18:** Company X obtains a loan from Bank Y. It grants Bank Y a security right over its computer equipment as security for the loan. Bank Y registers an initial notice in the Registry describing the computer equipment. Company X later sells the computer equipment and is paid in cash. Company X uses the cash to purchase a copying machine.

Company X then obtains a loan from Bank Z. It grants Bank Z a security right in the copying machine to secure the loan. Bank Z promptly registers an initial notice of its security right in the Registry describing the copying machine.

223. In example 18, Bank Y's security right in the computer equipment automatically extends to the money received by Company X and to the copying machine purchased with that money, as proceeds of the computer equipment (see Section II.A.12 and example 12).

224. However, Bank Y may need to register an amendment notice that describes the proceeds to preserve the third-party effectiveness and priority of its security right in the proceeds. This depends on what type of asset the proceeds are.

225. If the proceeds are money, receivables, negotiable instruments or funds in a bank account, the security right in the proceeds is effective against third parties without the need to take any additional steps (ML art.19(1)). In example 18, Bank Y's security

right in the money received by Company X is automatically effective against third parties and Bank Y does not need to register an amendment notice.

226. In example 18, Company X uses the cash to purchase the copying machine. Bank Y's security right in the copying machine is also automatically effective against third parties, but unlike money, receivables, negotiable instruments or funds in a bank account, only for a short time period specified by the enacting State (for example, 30 days). It continues to be effective against third parties after 30 days only if Bank Y registers an amendment notice to add the copying machine as an encumbered asset before the expiry of the 30-day period (ML art. 19(2)). If it does so, its security right in the copying machine has the same priority over a competing security right as the security right in the computer equipment (ML art. 32). In other words, Bank Y's priority over Bank Z will be preserved. If Bank Y registers an amendment notice after the 30-day period, its security right in the copying machine will only be effective against third parties from the time the amendment notice is registered. This means that it would be subordinate to the security right of Bank Z under the first-to-register rule (see Section II.G.1).

227. A secured creditor should not passively rely on the automatic extension of its security right to any proceeds of the encumbered asset. It should continuously monitor the encumbered assets to ensure that it finds out about the existence of any proceeds as soon as possible after they arise. This will enable the secured creditor to promptly take the necessary steps to preserve the third-party effectiveness and priority of its security right in the proceeds.

228. Continuous monitoring is important even if the proceeds are money, receivables, negotiable instruments or funds in a bank account. Although a secured creditor does not need to take any action to preserve the third-party effectiveness and priority of its security right in these types of proceeds, the security right continues only as long as the proceeds remain identifiable as being derived from the encumbered asset.

*The grantor has disposed of the encumbered asset without authorization, and the secured creditor wants to add the buyer as a new grantor*

**Example 19:** Company V grants Bank Y a security right in its computer equipment. Bank Y registers an initial notice identifying Company V as the grantor and describing the computer equipment. Company V later sells the computer equipment to Company W. The sale is not in the ordinary course of Company V's business.

**Example 19A:** Company W then grants Bank Z a security right in the computer equipment.

**Example 19B:** Company W then sells the computer equipment to Company X.

<For ease of reference, the computer equipment is being transferred from Company V to W to X. Bank Y and Z are secured creditors. >

229. Registration of a notice generally protects a secured creditor from an unauthorized sale of an encumbered asset by the grantor. Unless the asset is sold in the ordinary course of the grantor's business, the security right will continue in the asset in the hands of the buyer, who is regarded as a grantor of the security right (ML arts. 2(o) and 34, see Section II.G.2 and example 22).

230. A secured creditor that has registered an initial notice is generally not required to update the registration to reflect an unauthorized sale of an encumbered asset by the grantor. However, once the asset has been sold by the grantor and is in the hands of the buyer, a searcher is likely to search the Registry using the name of the buyer. That search will not reveal the initial notice, since it was registered using the name of the original grantor (the seller). For this reason, the secured creditor may need to register an amendment notice adding the buyer as a grantor in order to preserve the third-party effectiveness and priority of its security right against any subsequent

secured creditors or buyers. Whether and when this is necessary depends on which option in article 26 of the Model Registry Provisions is chosen by the enacting State.

Option A	<p>Bank Y needs to register an amendment notice adding the buyer (Company W) as a new grantor after the sale and before the expiry of the time period specified by the enacting State.</p> <p>This is necessary to preserve the third-party effectiveness and priority of Bank Y's security right as against a subsequent secured creditor who is granted a security right by Company W (Bank Z in example 19A) and as against a subsequent buyer who purchases the asset from Company W (Company X in example 19B).</p>
Option B	<p>Bank Y needs to do the same for Option A, but the time period for Bank Y to register an amendment notice does not begin until Bank Y finds out that Company V sold the computer equipment to Company W.</p>
Option C	<p>Bank Y does not need to register an amendment notice or take any other step to preserve the third-party effectiveness and priority of its security right against a subsequent secured creditor (Bank Z in Example 19A) or a subsequent buyer (Company X in example 19B).</p> <p>Despite this, Bank Y may still want to register an amendment notice adding Company W as a new grantor. This would ensure that searchers of the Registry are made aware of Bank Y's security right in the computer equipment in the hands of Company W.</p> <p>In enacting States that choose this option, the burden would be on Bank Z in example 19A and Company X in Example 19B to investigate whether Company W acquired the computer equipment subject to a security right granted by a previous owner (Company V) (see Section II.C.3 and example 15).</p>

231. In enacting States that have chosen either option A or B, Bank Y can register an amendment notice even after the time period specified by the enacting State expires. However, Bank Y would not have priority over a subsequent secured creditor that registered its initial notice, or a subsequent buyer that purchased the computer equipment, before Bank Y registered the amendment notice.

*The secured creditor wants to extend the period of effectiveness of the registration*

232. If a secured creditor expects that the period of effectiveness of its registration will need to be extended so that its security right continues to be effective against third parties, it should register an amendment notice extending the period (MRP art. 14(2), see Section II.E.5).

233. If an amendment notice extending the period of effectiveness is not registered and the registration expires, the security right will no longer be effective against third parties. While third-party effectiveness can be re-established by registering a new initial notice, the security right will be effective against third parties only as of the time the new notice is registered (ML art. 22).

## 9. Who can register a cancellation notice, when and how?

234. A security right will be extinguished when all secured obligations have been discharged and there are no outstanding commitments to extend credit (ML art. 12, see Part II.G bis). As the only person allowed to register a cancellation notice is the person identified as the secured creditor in the registration, the secured creditor should register a cancellation notice to reflect the extinguishment of a security right (MRP art. 16). The only information required in the cancellation notice is the registration number of the initial notice (MRP art. 19).

235. A secured creditor should be particularly careful when it submits a cancellation notice to the Registry, because the registration will cease to be effective once the cancellation notice is registered. If the registration relates to security rights created under several security agreements, for example, the secured creditor should not submit a cancellation notice simply because an obligation secured under one of the security agreements has been satisfied. Similarly, if a registration relates to more than one grantor, the secured creditor should not submit a cancellation notice simply because one of the grantors is being released. Instead, it should submit an amendment notice to remove the released grantor from the registration.

#### 10. Obligation to register an amendment or cancellation notice

236. It will be difficult for the person identified as the grantor in a registration to sell or grant a security right in assets described in the registration even if those assets are in fact not encumbered.

237. This situation could arise, for example:

- If a secured creditor registered a notice in anticipation of entering into a security agreement, but the transaction eventually did not take place
- If the obligations secured by a security right to which the registration relates have been satisfied and the parties do not intend to enter into any future security agreements; and
- If the description of the encumbered assets in the registration is overly broad and includes assets that are not intended to be encumbered.

238. The following table sets out some of the circumstances where the secured creditor will be required to register an amendment or cancellation notice.

Circumstance	What the secured creditor must do
The grantor has not authorized a registration in relation to some of the assets described in the registration and has told the secured creditor that it will not do so (MRP art. 20(1)(a)).	Register an amendment notice that deletes the assets from the description in the registered notice.
The grantor authorized the registration in relation to all the assets described therein, but a security agreement has not been entered into for some of the assets and the grantor has withdrawn its authorization with respect to those assets (MRP art. 20(1)(c)).	
The grantor has not authorized the registration at all and has told the secured creditor that it will not do so (MRP art. 20(3)(a)).	Register a cancellation notice.
The grantor authorized the registration, but no security agreement has been entered into and the grantor has withdrawn its authorization (MRP art. 20(3)(b)).	
The security agreement has been amended to release some assets, and the grantor has not otherwise authorized a registration covering those assets (MRP art. 20(1)(b)).	Register an amendment notice that deletes the assets from the registered notice.

<b>Circumstance</b>	<b>What the secured creditor must do</b>
The security right to which the registration relates has been extinguished (MRP art. 20(3)(c)), see Part II.G bis).	Register a cancellation notice.

239. A secured creditor can charge a fee for registering an amendment or cancellation notice only in the last two circumstances mentioned in the table (MRP art. 20(4)).

240. In most case, a secured creditor will voluntarily comply with its obligation to register an amendment or cancellation notice. If it does not, the grantor can send a written request to the secured creditor asking it to do so. In that case, the secured creditor cannot charge a fee for registering the requested notice even in the last two circumstances mentioned in the table (MRP art. 20(5)). A template for requesting the registration of an amendment or cancellation notice can be found in Annex VII.

241. If, after receiving the grantor's request, the secured creditor does not register the requested notice within a time period specified by the enacting State, the grantor can apply to the court or other authority to issue an order for the registration of the notice (MRP art. 20(6)). When the order is issued, the Registry must register the notice without delay (MRP art. 20(7)).

#### 11. Unauthorized registration of an amendment or cancellation notice

242. Only the person identified in the registration as the secured creditor is allowed to submit an amendment or cancellation notice (see Section II.E.8 and 9). In addition, the secure access requirements set by the Registry need to be met to submit an amendment or cancellation notice (MRP art. 5(2)). Secured creditors should take care to maintain the confidentiality of the secure access codes or other credentials issued to them in order to guard against the risk of unauthorized registration of an amendment or cancellation notice.

243. In the event that a secured creditor's precautionary efforts prove insufficient, the Model Law provides enacting States with different options for dealing with the situation where an amendment or cancellation notice is registered without the secured creditor's authorization (MRP art. 21). The table below sets out the consequences of the unauthorized registration of an amendment or cancellation notice under the different options.

	<b>The effectiveness of an unauthorized amendment or cancellation notice</b>	<b>The consequence</b>
Option A	The unauthorized amendment notice is effective.	The registration to which the amendment notice relates is amended in accordance with the amendment notice.
	The unauthorized cancellation notice is effective.	The registration to which the cancellation notice relates is no longer effective.
Option B	The unauthorized amendment or cancellation notice is effective. There is an exception for a competing claimant whose rights arose before the unauthorized registration and over which the secured creditor had priority	The result is the same as under option A. With respect to the competing claimant, the priority of the secured

	<b>The effectiveness of an unauthorized amendment or cancellation notice</b>	<b>The consequence</b>
	before the unauthorized registration	creditor over the competing claimant is preserved.
Option C	The unauthorized amendment notice is ineffective.	The registration to which the amendment notice relates is not affected by the amendment notice.
	The unauthorized cancellation notice is ineffective.	The registration to which the cancellation notice relates is not affected by the cancellation notice.
Option D	The unauthorized amendment or cancellation notice is ineffective.  There is an exception with respect to a competing claimant who searched the Registry after the unauthorized registration and who did not know that the registration was unauthorized when it acquired its right.	The result is the same as under option C.  With respect to the competing claimant,  The registration to which the amendment notice relates is amended in accordance with the amendment notice.  The registration to which the cancellation notice relates is no longer effective.

244. In States that choose option A or B, the secured creditor should register an amendment notice correcting the amended information as soon as it becomes aware that an amendment notice has been registered without its authorization. For example, if the unauthorized amendment notice deleted some assets from the description of encumbered assets in the registration, the secured creditor should register an amendment notice again adding those assets. The secured creditor should, however, bear in mind that the registration of the new amendment notice makes its security right in those assets effective against third parties only from the time it is registered (except with respect to competing claimants described above in States that choose option B over which the secured creditor will continued to have priority).

245. Similarly, in States that choose option A or B, the secured creditor should register a new initial notice as soon as it becomes aware that a cancellation notice has been registered without its authorization. However, the registration of the new initial notice only makes the security right effective against third parties from the time it is registered (except with respect to competing claimants described above in States that choose option B over which the secured creditor will continued to have priority).

246. In States that choose option C, the secured creditor does not need to register a new initial notice or an amendment notice, because the registration is not affected by the unauthorized amendment or cancellation notice. The same applies in States that choose option D except as against competing claimants described in the table above. To protect itself against these competing claimants, the secured creditor should register a new initial notice, although it will provide protection only if the new initial notice is registered before the competing claimant acquired its rights.

247. More generally and regardless of the option chosen by the enacting State, a secured creditor should seek measures against the third party that registered an

amendment or cancellation notice without its authorization and possibly recover any damages for such action.

248. In States that choose option A or B, the registration of a cancellation notice results in all related notices being removed from the public records of the Registry, so that a search will no longer disclose the security right to which the cancellation notice relates (MRP art. 30, option A). This does not affect the information needs of searchers because the cancellation notice is effective even if its registration was not authorized. This is the case even under option B because the exception only relates to competing claimants whose right in the asset arose before the unauthorized registration.

249. In States that choose options C or D, the registration of a cancellation notice does not result in the related notices being removed from the public records of the Registry (MRP art. 30, option B, para. 2). A search using the name of the grantor will continue to disclose the cancellation notice and all related notices.

250. The same applies under all options when an amendment notice is registered. The information in the registration that was modified continues to appear in the search result. However, in States that choose options C or D, an unauthorized cancellation or amendment notice is generally not effective. This means that searchers in States that choose options C or D who are interested in the assets described in a registered cancellation or amendment notice will need to contact the secured creditor or conduct other inquiries to verify whether it authorized the registration.

## **12. Registration in other registries**

251. Under the Model Law, the Registry is the place to register notices relating to security rights in most types of movable assets (ML arts.1(1)-(2)). However, some enacting States may require rights in certain types of assets to be registered in a separate asset-specific registry (ML art. 1(3)(e)). There are also international registries established by international conventions applicable in the enacting State. The following are some examples of assets that may be subject to a specialized registration regime:

- Trademarks, patents and copyrights;
- Motor vehicles;
- Aircraft frames, aircraft engines and helicopters;
- Ships; and
- Assets associated with immovable property (for example, timber, growing crops, attachments to immovables, rents or other revenue streams derived from immovable property).

## **F. The need for continued monitoring**

### **1. General**

252. Due diligence is not merely something to be conducted at the outset of a secured transaction (see Part II.B). A secured creditor should continue to monitor the grantor and the encumbered asset throughout the entire duration of the transaction. This will increase the likelihood that the secured creditor receives the maximum benefit from the encumbered asset.

253. This Part discusses basic tools that a secured creditor can use to monitor a secured transaction. Some of these tools relate to the monitoring of the grantor, while others relate to the monitoring of the encumbered asset. These tools will usually be agreed in the security agreement.

254. Monitoring tools for secured lending are typically used in addition to, and not in substitution of, monitoring tools for unsecured lending. Therefore, a secured creditor should also monitor the borrower (particularly, if different to the grantor) throughout the duration of the loan (for example, by requiring the borrower to agree to provide periodic financial statements and to comply with various financial and other covenants). This Part, however, focuses on monitoring as it relates to a “secured” transaction.

255. The appropriate tools to use for monitoring will depend on a number of factors, including who the grantor is, the type of secured transaction, and the type of encumbered asset. The extent to which monitoring is necessary will also have an impact on the cost of financing. As for due diligence, a secured creditor can also use third parties when monitoring.

256. Monitoring should not unduly interfere with the grantor’s ability to conduct its business. In setting out the secured creditor’s monitoring rights, a security agreement will often contain provisions specifying the number and frequency of appraisals and inspections that the secured creditor can conduct and when they can be done (for example, after giving the grantor reasonable notice, and only during the grantor’s normal business hours, see section 4 of Sample Security Agreement B).

257. If the grantor is in default, however, the secured creditor should be able to undertake inspections with less deference to its effect on the operation of the grantor’s business. For example, a security agreement may state that the secured creditor can conduct an unlimited number of inspections, if the grantor is in default.

## **2. Continued monitoring of the grantor**

258. A secured creditor should conduct periodic monitoring of the grantor to detect changes that may require additional action to protect its security right. In particular, a secured creditor will want to monitor any changes in the grantor’s name and address, any mergers, or other changes affecting the grantor’s legal status, because a secured creditor may need to register an amendment notice (see Section E.8 and example 17).

259. A secured creditor should also monitor whether any claims have been raised against the grantor by third parties, particularly claims that may have priority over its security right (see Sections G.5 and G.6 as well as examples 25 and 26). A secured creditor should ask the grantor or search the relevant registries to determine whether any such claims exist and deal with them accordingly (for example, by requiring that the claims be paid, or subordinated to the secured creditor’s security right). A security agreement typically gives the secured creditor the right to withhold further credit until this is done. A secured creditor should also monitor the commencement of any insolvency proceedings with respect to the grantor so that it can respond appropriately.

## **3. Continued monitoring of the encumbered asset**

260. A secured creditor should regularly monitor the encumbered asset. This is also important for all types of secured transactions. For example, when a secured creditor takes security over an item of equipment, it should check whether the equipment remains in the agreed location and is being properly maintained. It should also check that the grantor is in possession of asset and has not disposed of the equipment. In that circumstance, a secured creditor would need to register an amendment notice to protect its security right (see Section E.8 and examples 18 and 19). The same applies to other types of encumbered asset.

**Example 20:** Company X sells kitchen appliances to restaurant owners. Many of its sales are on credit and the restaurant owners are given 60 days to pay for the appliances.

Bank Y provides Company X with a line of credit, under which Company X can draw down a loan when it needs money to buy inventory or pay other expenses before it is paid by the restaurant owners. Company X gives Bank Y a security right in all its existing and future inventory and receivables as security for the line of credit.

261. Monitoring of the encumbered asset is particularly important in the case of a revolving loan secured by inventory and receivables, where the amount of credit that the lender is prepared to make depends on the value of the inventory and receivables. In example 20 (which is based on examples 10 and 14), borrowings and repayments will be frequent, and the amount of the loan will constantly fluctuate. The pool of encumbered inventory and receivables will also fluctuate as inventory is acquired and converted into receivables, the receivables are collected, and new inventory is acquired. The overall amount of the loan that Bank Y is willing to provide to Company X will depend largely on Bank Y's valuation of the encumbered inventory and receivables from time to time. This means that Bank Y needs to monitor the pool of inventory and receivables frequently.

262. For this purpose, the security agreement may require the grantor to advise the secured creditor of any significant change in the pool of inventory and receivables (for example, if the inventory is moved to a different location).

263. The security agreement may require the grantor to provide the secured creditor with updated information about the inventory and receivables on a regular basis (for example, every week or every month). The secured creditor can use this information to ensure that the outstanding principal amount of the loan never exceeds an appropriate proportion of the value of the underlying pool of inventory and receivables. This amount is sometimes referred to as the "borrowing base". Annex VIII provides an example of a borrowing base certificate.

264. In example 20, the agreement between Company X and Bank Y will usually state that if the outstanding loan amount exceeds the borrowing base, Company X is required to repay the excess amount. Company X's failure to make this repayment will likely be an event of default (see Section D.3) and will entitle Bank Y to enforce its security right. In this way, Bank Y can ensure that Company X's obligations under the agreement are adequately secured by the encumbered asset at all times.

265. Bank Y should not rely simply on a borrowing base certificate. Rather, Bank Y should consider including provisions in the security agreement that allows it to take other steps on a regular basis to verify the value of the encumbered asset. In the case of the inventory, Bank Y can, for example, arrange for a periodic appraisal or inspection. In the case of the receivables, Bank Y can periodically verify the existence and face amount of the receivables by contacting the debtors of the receivables.

266. Bank Y can also conduct on-site inspections, where its representative will visit Company X's premises, reviews its books and records and inspect the inventory that is on hand. One benefit of an inspection is that it may uncover inadvertent or intentional actions by Company X that could have an adverse impact on Bank Y's security right. For example, Company might have relocated the inventory from one third-party warehouse (where the warehouse operator had entered into an access agreement with Bank Y with respect to the inventory) to another third-party warehouse (where the operator had not entered into a similar agreement with Bank Y). The change in location may be revealed by an on-site inspection, and Bank Y could then address the issue by obtaining an access agreement from the new warehouse operator.

## G. Determining the priority of a security right

267. A secured creditor may find that its security right in an encumbered asset is in competition with the rights of one or more competing claimants in the same asset. Such rights may have been in existence before the secured creditor entered into the secured transaction (see Section B.3) or may have arisen afterwards. Moreover, the priority of a security right may change over the duration of the transaction. Ultimately, its rank will be determined at the time the security right is enforced against the encumbered asset.

268. This Part explains how the priority rules of the Model Law resolve the competition between a security right in an encumbered asset and the right of a competing claimant in the same asset. While this Part is written mainly from the perspective of a secured creditor, it will also be useful for competing claimants who should also understand their rights under the Model Law.

### 1. First-to-register rule

**Example 21:** Company X has a printing business and obtains a loan of €10,000 from Bank Y. Bank Y takes a security right in Company X's printing press as security for the loan. Bank Y registers a notice in the Registry on 18 October 2020. Company X obtains a loan of €8,000 from Bank Z. Bank Z also takes a security right in the printing press and registers a notice in the Registry on 1 December 2020.

269. In example 21, Company X has granted two security rights in the printing press. This creates a priority competition between two secured creditors, Bank Y and Bank Z. The general rule is that priority between competing security rights is determined by the order in which notices relating to the security rights are registered in the Registry (ML art. 29(a)). Bank Y has priority over Bank Z because it registered its notice first.

270. Bank Z can also make its security right effective against third parties by taking possession of the printing press (see Section A.2 and example 2). If Bank Z takes possession of the printing press before Bank Y registered its notice and retained possession, it will have priority over Bank Y.

271. The priority of a security right is not affected by the fact that the secured creditor knew or may have known of the existence of a competing security right when it acquired its own security right (ML art. 45). For example, the fact that Bank Y knew that Company X was about to enter into a secured transaction with Bank Z or the fact that Bank Y registered a notice even before it entered into a security agreement with Company X to obtain priority over Bank Z is irrelevant for determining the priority. Bank Y has priority because it registered before Bank Z.

### 2. Buyers, lessees and licensees of an encumbered asset

**Example 22:** Company X has a coffee machine and obtains a loan from Bank Y. Bank Y takes a security right in the coffee machine to secure the loan. Bank Y registers a notice in the Registry on 18 October 2020. Afterwards, Company X sells the coffee machine to Company Z for cash.

*The general rule – subject to the security right*

272. The general rule of the Model Law is that a security right in an asset that has been made effective against third parties will not be affected by a sale, lease or licence of the asset (ML art. 34 (1)). This means that a buyer, lessee or licensee of an encumbered asset will acquire the asset subject to the security right. In example 22, Company Z acquires the coffee machine subject to Bank Y's security right.

Company Z should have searched the Registry before it bought the coffee machine to see whether there were any existing security rights over it (see Section C.2).

*Exception 1 – with the secured creditor’s agreement*

273. There are a few exceptions to this general rule. The first exception is where the secured creditor agrees that the encumbered asset can be sold free of the security right (ML art. 34(2)). If Bank Y had agreed that Company X could sell the coffee machine free of Bank Y’s security right, Company Z acquires the coffee machine without it being subject to Bank Y’s security right. Bank Y might have agreed to the sale because its security right will extend to the cash received by Company X from the sale (see Section A.12 and examples 12 and 18).

*Exception 2 – in the ordinary course of business of the grantor*

274. Another exception is where the grantor sells a tangible encumbered asset in the ordinary course of its business. In that case, the buyer will usually acquire the asset free of any security right (ML art. 34(4)). For example, if Company X were in the business of selling coffee machines, Company Z would acquire the coffee machine free of Bank Y’s security right, whether or not Bank Y had agreed to the sale. This rule applies only to buyers but not to other transferees, for example, a person that is given an encumbered asset as a gift.

275. There is one qualification to this exception. Company Z will not take the coffee machine free of Bank Y’s security right if the sale was in breach of the terms of the security agreement between Company X and Bank Y, and if Company Z knew of the breach. In that case, Company Z’s right in the coffee machine would be subject to Bank Y’s security right and Company Z would not be protected.

276. The fact that Company Z was able to know or knew that Bank Y’s security right existed in the coffee machine because Bank Y had registered a notice in the Registry would not disqualify the protection provided to Company Z. In other words, mere knowledge of the existence of a security right is irrelevant. It is only when Company Z knew that the sale would be in breach of the security agreement that Bank Y can preserve its security right in the coffee machine. In any case, Company X may be liable for its breach of the security agreement.

### 3. Super-priority of an acquisition security right

**Example 23:** Company X has a printing business. Bank Y makes a loan to Company X and takes a security right in all of Company X’s equipment and inventory, including equipment and inventory that Company X will buy in the future, as security for the loan. Bank Y registers a notice in the Registry on 18 October 2020. In January 2021, Company X buys some computers for use at its headquarters and paper for printing from Vendor Z. Vendor Z’s terms of sale state that it retains title to the computers and the paper until Company X has paid the purchase price in full.

277. In example 23, both Bank Y and Vendor Z have a security right in the computers and the paper purchased by Company X. Under the general first-to-register rule, Bank Y has priority over Vendor Z, because its notice covered the computers and the paper (as future equipment and inventory) and was registered first.

278. However, the Model Law has a special priority rule for a secured creditor whose financing enables the grantor to acquire a right in the asset (“acquisition secured creditor”, see examples 5A to 5D). An acquisition secured creditor that meets the requirements in the Model Law has priority over a competing non-acquisition secured creditor, even if the competing non-acquisition secured creditor registered a notice first.

279. Vendor Z has an acquisition security right in the computers, which Company X bought for the operation of its business. If such equipment is encumbered, Vendor Z will have priority over Bank Y if Vendor Z registers a notice in the Registry after it delivers the computers to Company X. And the notice needs to be registered within the time period specified by the enacting State (ML art. 38, options A and B, para. 1).

280. Vendor Z also has an acquisition security right in the paper, which Company X bought to print brochures for its customers. If such inventory is encumbered, the steps that an acquisition secured creditor needs to take will depend on whether the enacting State has chosen option A or B of article 38 of the Model Law.

- If the enacting State has chosen option A, Vendor Z will have priority over Bank Y, if it registers a notice in the Registry and notify Bank Y that it is taking security over the paper before it delivers the paper to Company X (ML art. 38 option A, paras. 2 and 4).
- If the enacting State has chosen option B, the rule that applies to an acquisition security rights in equipment applies equally to an acquisition security right in inventory (ML art. 38 option B, para. 1). Like for the computers, Vendor Z will have priority over Bank Y in the paper if it registers a notice in the Registry after it delivers the paper to Company X and do so within the time period specified by the enacting State.

281. Accordingly, Bank Y should be careful if it plans to lend money based on the value of the computers and the paper acquired by the Company X with the assumption that it would have the highest-ranking security right, having registered first. To be sure that it has priority in the computers and the paper, it should search the Registry after the expiry of specified time period to see whether an acquisition secured creditor like Vendor Z has registered a notice covering the asset (see Section I.C.2). This may, however, not be necessary with regard to the paper if the enacting State has chosen option A, as Vendor Z would need to notify Bank Y that it is taking a security in the paper to have priority.

282. A secured creditor whose financing enables the grantor to acquire a right in the asset for personal, family or household purposes (“consumer goods”) does not need to take any steps to have priority over a competing non-acquisition secured creditor (ML art. 38 option A, para. 3 and option B, para. 2).

#### 4. Insolvency of the grantor

**Example 24:** Bank Y makes a loan to Company X and takes a security right in Company X’s inventory and receivables as security for the loan. Bank Y registers a notice in the Registry. Company X’s business later fails. Company X files for insolvency.

283. If a security right has been made effective against third parties, it will remain effective against third parties even if the grantor becomes insolvent. The commencement of insolvency proceeding against the grantor will also not affect the priority of a security right, unless the insolvency law of the enacting State gives priority to other claimants (ML art. 35). For example, the insolvency representative may be given priority to retrieve costs of the insolvency proceeding.

284. In example 24, Bank Y’s security right will be recognized in the insolvency proceedings and will retain its priority unless the insolvency law of the enacting State provides otherwise.

## 5. Preferential claims

**Example 25:** Bank Y makes a loan to Company X and takes a security right in Company X's inventory and receivables as security for the loan. Bank Y registers a notice in the Registry. Company X struggles to manage its cash flows and therefore is late in paying its taxes and the wages of its employees.

285. As a matter of policy, an enacting State may give some claims priority over a security right even if the security right has been made effective against third parties (ML art. 36). These claims, which arise by operation of other laws, are referred to as "preferential claims" under the Model Law. Examples of preferential claims include claims for unpaid taxes and claims by employees for unpaid wages. It is suggested that any such claims be listed in a clear and specific way when the enacting State adopts the Model Law and that a cap be set on the amount of the claim that would be given priority.

286. A secured creditor should check whether and what type of preferential claims are recognized in the enacting State, as they could have an impact on its security right. For example, if the enacting State in example 25 recognizes claims for unpaid taxes up to £10,000 and claims for unpaid wages up to three months per employee as preferential claims, Bank Y should calculate the potential total amount and deduct it from the amount of credit that it would otherwise be prepared to extend (see sections 8 and 9 of the Sample Diligence Questionnaire in Annex III).

## 6. Judgment creditor

**Example 26:** Bank Y makes an unsecured loan to Company X. Company X does not repay the loan when due and Bank Y obtains a judgment for payment from the court. The law of the enacting State requires a creditor who has obtained a judgment and intends to enforce the judgement against an asset to register a notice of the judgment in the Registry.

Company X borrows money from Bank Z. Bank Z takes a security right in Company X's printing press as security for the loan. Bank Z registers a notice in the Registry.

287. A creditor that has obtained a judgment or provisional order for payment of what is owed from a court (a "judgment creditor") may have priority over a secured creditor if it takes the steps specified by the enacting State.

288. If a judgment creditor takes those steps against an encumbered asset before a secured creditor makes its security right effective against third parties, the judgment creditor has priority over the secured creditor (ML art. 37(1)). In example 26, if Bank Y registers its judgment in the Registry before Bank Z registers its notice, Bank Y will have priority. If Bank Z registers its notice first, Bank Z will have priority and Bank Y's right in the printing press would be subject to Bank Z's security right.

289. Even when a judgment creditor acquires a right in an asset, a secured creditor can have priority if it made its security right effective against third parties before or at the time the judgment creditor acquired its right. That priority is, however, limited (ML art. 37(2)). In example 26, if Bank Z registers its notice before Bank Y acquires a right in the printing press, Bank Z will have priority. But its priority is limited to the amount that Bank Z had already provided to Company X and any other amount that Bank Z has committed to extend before Bank Y notified Bank Z that it has registered a notice of the judgment in the Registry. This requirement prevents Bank Z from unduly increasing the amount owed by Company X after it finds out that a judgment creditor was taking steps to acquire rights in the encumbered asset.

290. A judgment creditor should conduct a search of the Registry before and after it obtains a judgment to check if there are any notices relating to the debtor's assets.

This can help a judgment creditor to identify assets against which it will enforce the judgment. A judgment creditor should also take the steps required in the enacting State and notify any relevant secured creditor that it has taken those steps. Both should be done as soon as possible to maximize the recovery prospects.

291. In the same vein, a secured creditor should register a notice in the Registry as soon as possible to have priority over any potential judgment creditors. It should ensure that a notice is registered before the judgment creditor takes the steps required in the enacting State and before the judgment creditor acquires rights in the asset. This would increase the likelihood that its security right has priority over the right of a judgment creditor, though the priority of the security right might be limited.

### **G bis. Extinguishment of a security right**

*[Note to the Commission: The Commission may wish to consider whether the following examples and commentary on the extinguishment of a security right needs to be included in the Practice Guide and if so, their placement. At present, it is presented as Part G bis following the life cycle of a secured transaction. The extinguishment of a security right is also discussed in Section II.B.4 in the context of actions to be taken when there is a higher-ranking competing claimant and in Sections II.E.9 and 10 in the context of instances that require the registration of a cancellation notice.]*

**Example 27A:** Company X obtains a loan from Bank Y. Bank Y takes security over Company X's printing press as security for the loan. Company X repays the loan in full.

**Example 27B:** Company X purchases drilling equipment from Vendor Z. The terms of the sale give Company X 30 days to pay for the drilling equipment and state that Vendor Z retains title to the drilling equipment until Company X pays the purchase price in full. Company X pays the full amount after 20 days.

**Example 27C:** Company X obtains a revolving loan from Bank Y, under which Company X can draw down loans from time to time when it needs money to buy inventory or pay other expenses. Bank Y takes a security right in all of Company X's existing and future inventory and receivables as security for the revolving loan.

292. A security right is extinguished when all the secured obligations have been satisfied in full and the secured creditor is not under any commitment to extend further credit that would be secured by the security right (ML art. 12). In example 27A, Bank Y's security right is extinguished as Company X has repaid the loan in full, unless there is an on-going commitment by Bank Y to extend another secured credit. In example 27B, Vendor Z's security right is extinguished as Company X has paid the purchase price in full. In contrast, Bank Y's security right in example 27C will not extinguish simply because Company X may have paid down the revolving loan in full, if Bank Y remains committed to extend further credit to Company X.

293. When a security right is extinguished, the secured creditor that has registered an initial notice is required to register an amendment or cancellation notice to reflect the extinguishment (see Sections II.E.9 and 10). If the secured creditor made its security right effective against third parties by taking possession of the encumbered asset, it has to return the asset to the grantor.

## **H. How to enforce a security right**

### **1. Default and options for a secured creditor**

294. The occurrence of an event of default is a defining moment in a secured transaction. It is when the secured creditor will rely most on the effectiveness of its security right. A common default under a security agreement is the failure of the

debtor to pay the secured obligation, but parties can also agree on other events of default in the security agreement (see Section D.3).

295. In the event of default, there are a number of things that a secured creditor can do. For example, the secured creditor can offer to restructure the repayment schedule, take additional security over other assets, or assign its rights in the secured obligation along with the security right to a third party. These options may be preferable to enforcing the security right, particularly if the expected proceeds of the enforcement may be less than what is needed to discharge the secured obligation in full, as the secured creditor may not otherwise be able to recover all that it is owed.

296. A secured creditor should have a good understanding of how its security right can be enforced under the Model Law. It is important to have this understanding at the outset of a transaction, as it would help the secured creditor assess the value of the encumbered assets. It is also important to have this understanding in the event of default, as it will help the secured creditor decide whether to enforce its security right. This Part provides guidance on the enforcement options available to a secured creditor under the Model Law.

## 2. The basics of enforcement

### *The Model Law provisions and the security agreement*

297. A security right makes it possible for the secured creditor to recover what it is owed from the value of the encumbered asset. The Model Law has a number of provisions on how a secured creditor can go about this. The security agreement can also provide a secured creditor with other options for enforcing its security right.

298. Other laws can also have an impact on a secured creditor's enforcement option. They may provide additional options (for example, by allowing the secured creditor to sell the grantor's business in its entirety, see Sections II.A.4 and 6) or may limit or restrict the enforcement of a security right against certain persons or assets (see generally Section I.C.5).

### *Out-of-court enforcement*

299. A secured creditor can exercise its post-default rights by applying to a court or other authority specified by the enacting State. However, a secured creditor does not have to go to court and can instead enforce the security right by itself (ML art. 73(1)). This may be a significant change in many jurisdictions. Extrajudicial enforcement can make it possible for a secured creditor to recover what it is owed more quickly and more efficiently. However, the Model Law imposes conditions on how a secured creditor can undertake an extrajudicial enforcement to minimise the risk of misuse.

### *Different ways of enforcing a security right*

300. The Model Law provides a secured creditor with a number of ways to enforce its security right. For example, a secured creditor can:

- Sell the encumbered asset and recover what it is owed from the proceeds;
- Lease or license the encumbered asset, and recover what it is owed from the rent or royalty payments; or
- Acquire the encumbered asset in total or partial satisfaction of the amount due.

301. A secured creditor's choice on how to enforce will depend on a number of factors, including the type of asset and commercial circumstances. For example, if the encumbered asset is a tangible asset, the most common choice will be for the secured creditor to take possession and then dispose of the asset, typically by sale. If the encumbered asset is an intangible asset, the secured creditor can also dispose of the asset but has other options as well. For example, if the encumbered asset is a receivable, the secured creditor can collect the receivable directly from the debtor of

the receivable (ML art. 82). This can make it possible for the secured creditor to realize more of the value of the receivable than it would generate from a sale. If the encumbered asset is a bank account, the secured creditor can withdraw the balance credited to the bank account and use it to pay the secured obligation.

302. A secured creditor must exercise its enforcement rights under the Model Law in good faith and in a commercially reasonable manner, whichever option it chooses (ML art. 4).

### 3. A preliminary step in enforcement – take possession

**Example 28:** Company X has a delivery business. Bank Y makes a loan to Company X. Company X gives Bank Y a security right in its vans to secure the loan. Bank Y registers a notice in the Registry and does not take possession of the vans. Later, Company X defaults on the loan. Bank Y wants to enforce its security right.

303. The first thing that Bank Y will need to do to enforce its security right is take possession of the vans. Bank Y is entitled to take possession of the vans unless a person with a superior right already has possession of the vans, such as a higher-ranking competing claimant (ML art. 77(1)).

304. One option for Bank Y is to apply to a court to obtain possession. A court order will allow Bank Y to seize the vans even if Company X objects. Court proceedings can be an effective option if the grantor is not prepared to surrender the assets. However, this approach could lead to delays, and pose problems - particularly if the encumbered assets are perishable or declining rapidly in value.

305. For this reason, Bank Y is likely to prefer to obtain possession of the vans itself, without applying to a court or other authority. To take possession, however, Bank Y needs to satisfy three conditions (ML art. 77(2)). These conditions balance the rights of the secured creditor and the grantor and aim to protect the public interest by ensuring that enforcement processes are conducted in a lawful and peaceful manner.

- Firstly, Company X needs to consent in writing. This consent will usually be included in the security agreement but can also be given later.
- Secondly, Bank Y needs to notify Company X (and any other person in possession of the vans) in advance that Company X is in default and that Bank Y intends to take possession of the vans. However, the secured creditor does not need to do this if the encumbered asset is perishable or might rapidly decline in value (ML art. 77(3)).
- Thirdly, Bank Y can only take possession of the vans if the person in possession of the vans does not object. If that person objects, Bank Y will have to apply to a court to obtain possession.

306. A secured creditor that has a security right in more than one asset is entitled to seize all of the assets in order to enforce its security right. However, if the secured creditor takes possession of more than one asset when the value of only one of the assets will be sufficient to cover the secured obligation, the secured creditor may be in breach of its obligation to exercise its rights in good faith and in a commercially reasonable manner (ML art. 4). This may make the secured creditor liable for damages or other consequences, which is left to other laws of the enacting State.

### 4. Dispose of the encumbered asset

307. Once Bank Y has obtained possession of the vans, it will want to use them to recover what it is owed as quickly as possible. In most cases, Bank Y will want to sell the vans, so that it can use the sale proceeds to recover what it is owed.

308. One option would be for Bank Y to apply to a court to conduct the sale. The sale would then need to be in accordance with the relevant rules laid down by the enacting

State (ML art. 78(2)). While a court-supervised sale has its merits, it may not always be appropriate or the most suitable option.

309. Alternatively, Bank Y can sell the vans itself without applying to a court. Bank Y can manage the method, manner, time, place and other aspects of the sale, including whether to dispose of the vans individually or together (ML art. 78(3)).

310. Before Bank Y can sell any of the vans itself, it must give a notice to the following persons of its intention to go ahead with the sale (ML art. 78(4)):

- The grantor (Company X) and the debtor (if different to Company X);
- Any person with a right in any of the vans that had informed Bank Y of its right in writing before Bank Y notified Company X;
- Any other secured creditor that registered a competing security right in any of the vans before Bank Y notified Company X; and
- Any other secured creditor that was in possession of any of the vans when Bank Y took possession.

311. Bank Y must give a notice to those persons in advance of the sale (the time period is specified by the enacting State). The notice must contain the following information (ML art. 78(5)):

- A description of the vans;
- A statement of the amount that needs to be paid to Bank Y to satisfy the secured obligation (including interest and reasonable enforcement costs);
- A statement that the grantor (Company X), any other person with a right in any of the vans or the debtor (if different to Company X) may terminate the sale by paying the amount owing in full, including reasonable enforcement costs (ML art. 75);
- The date after which the vans will be sold; and
- The time, place and manner of the proposed sale.

312. The notice enables the recipients to verify whether the sale will take place under commercially reasonable conditions. If the sale does not take place under commercially reasonable terms, the secured creditor may be liable for damages caused by its breach. However, the grantor and other concerned parties cannot challenge the validity of the sale, unless it is proved that the buyer of the encumbered asset was aware that the sale violated the rights of the grantor or those concerned. A template of a notice can be found in Annex IX.

## **5. Other ways of enforcement**

### *Lease the encumbered asset*

313. It might not always be possible or desirable for a secured creditor to recover what it is owed by disposing of the encumbered asset. For example, there may not be a suitable secondary market for the asset and it might not be possible to find a buyer by other means. This would mean that a sale of the encumbered asset will not yield a suitable price. In those circumstances, Bank Y can enforce its security right in a different way. For example, Bank Y may decide to lease the vans and apply the rental payments towards the amount due. To do this, Bank Y must follow the same procedure as required for disposing the encumbered asset.

### *Acquire the encumbered asset*

314. Bank Y can offer to acquire the vans itself, in full or partial satisfaction of what it is owed. Company X can also make a similar offer. In either case, Bank Y would then become the owner of the vans, and the value of the vans would be offset against the amount due. The advantage of this method is that Bank Y acquires all the rights

and powers of ownership of the vans and can dispose of them freely at a later time, if it wishes to do so.

315. This enforcement option is subject to procedural safeguards, similar to the ones that apply to a sale of the encumbered asset (ML art. 80). Bank Y's proposal to acquire the vans must be in writing and sent to the same persons as required for the sale of the encumbered asset (ML art. 80(2)).

316. The proposal must contain the following information (ML art. 80(3)):

- A statement of the amount required to satisfy the secured obligation (including interest and reasonable enforcement costs) at the time the proposal;
- A description of the vans as encumbered asset;
- Whether Bank Y intends to acquire the vans in satisfaction of all the secured obligation, or only part;
- A statement that Company X, any other person with a right in any of the vans, or the debtor (if different to Company X) may terminate the acquisition by paying the amount owing in full, including reasonable enforcement costs; and
- The date after which Bank Y will acquire the vans.

317. A template for proposing the acquisition of the encumbered asset can be found in Annex X.

318. Other conditions that Bank Y needs to meet to acquire the vans differ depending on whether the acquisition is in full or partial satisfaction of what Bank Y is owed. If it is in full satisfaction of what Bank Y is owed, Bank Y will acquire the vans unless one of the recipients of the proposal objects in writing within a short time period specified by the enacting State (ML art. 80(4)). If it is in partial satisfaction of what Bank Y is owed, Bank Y will only acquire the vans if all recipients of the proposal consent in writing within a short period of time specified by the enacting State (ML art. 80(5)). If these conditions are not met, Bank Y will need to rely on a different enforcement method instead.

#### *Collect payment*

319. If the encumbered asset is a receivable, a negotiable instrument or a bank account, a secured creditor can enforce its security right by collecting payment directly from the debtor of the receivable, the obligor under the negotiable instrument or the deposit-taking institution (ML art. 82).

**Example 29:** Company X sells household appliances to home developers. Many of its sales are on credit, with developers paying for the appliances over time. Company X needs operating funds from time to time to pay its expenses. Bank Y provides Company X with a line of credit, under which Company X can draw down a loan when it needs money. Bank Y takes security right in all of Company X's existing and future receivables as security for the line of credit. Company X defaults. Bank Y wants to enforce its security right in the receivables.

320. In example 29, Bank Y can collect payments from Company X's customers and use the payments to recover what it is owed, rather than sell the receivables. However, Bank Y needs to be aware that its right to collect payment is subject to the provisions in the Model Law protecting the debtors of the receivable (ML arts. 61–67, see Section II.B.10 and example 10).

321. The enforcement provisions of the Model Law do not apply to outright transfers of receivables (ML art. 1(2)). This is because there is no secured obligation involved. A transferee under an outright transfer is entitled to collect the receivable at any time after payment becomes due (ML art. 83). That is because the outright transferee is the owner of the receivable and is entitled to keep whatever it collects, regardless of the

amount it paid for the receivable. In other words, an outright transferee bears the risk of not being able to collect the face value of a receivable and an outright transferee does not need to return to the transferor any amount collected in excess of the amount it paid for the receivable (see Section II.A.9 and example 9)

## 6. Terminating an enforcement process

**Example 30:** Bank Y takes security over Company X's printing press to secure the loan that it made to Company X. Bank Z also makes a loan to Company X but does not take security over any of Company X's assets.

Later, Company X defaults. Bank Y takes possession of the printing press and plans to sell it through a public auction. Bank Z is willing to advance additional credit to Company X so that it can repay the loan to Bank Y.

322. An affected person (the grantor, any other person with a right in the encumbered asset or the debtor) can terminate an enforcement process by paying the secured creditor what it is owed, including any reasonable enforcement costs (ML art. 75(1)).

323. In example 30, Bank Z is affected by the enforcement process as an unsecured creditor of Company X. Bank Z can terminate the enforcement process by advancing funds to Company X and arranging for Company X to use the funds to pay Bank Y the amount owing plus any reasonable enforcement costs (for example, costs that Bank Y may have incurred to repossess and store the printing press). However, this needs to be done before Bank Y enters into an agreement with a third party to sell the printing press (ML art. 75(2)).

## 7. Taking over an enforcement process

**Example 31:** Ms. X runs a restaurant. Bank Y provides Ms. X with a loan, which is due for repayment on 20 October 2021. Bank Y takes a security right in Ms. X's kitchen appliances. Bank Y registers a notice in the Registry on 18 October 2019.

Ms. X then obtains another loan from Bank Z. Bank Z also takes a security right in the same kitchen appliances. Bank Z registers a notice in the Registry on 1 December 2019. Bank Z's loan is due for repayment on 30 June 2021. On 1 July 2021, Ms. X is not able to repay Bank Z's loan.

324. In example 31, Ms. X will be in default under the loan agreement with Bank Z. Ms. X is not yet in default under its loan agreement with Bank Y, as repayment is not due until 20 October 2021. However, Bank Z's security right does not have priority over Bank Y's security right because the relevant notice was registered later.

325. In these circumstances, Bank Z can enforce its security right but its right in the kitchen appliances is subject to Bank Y's rights as the higher-ranking secured creditor. Bank Y, as the higher-ranking secured creditor, can also take over the enforcement process at any time before the enforcement is completed (ML art. 76).

326. While the Model Law provides a higher-ranking secured creditor with this right to take over enforcement, a secured creditor should ensure that it can take over enforcement and protect its rights in these types of situations by providing in the security agreement that if any third party starts to enforce a claim against the encumbered asset, it is an event of default (see Section D.3).

## 8. Distribution of proceeds and rights acquired after enforcement

**Example 32:** In example 31, Bank Y takes over enforcement, and sells the kitchen appliances to Ms. V for ¥150,000. Bank Y's loan amount was ¥100,000. Bank Y is owed ¥5,000 of unpaid interest. Bank Y also incurred ¥10,000 of enforcement expenses. Bank Z is owed ¥50,000.

*Distribution of proceeds*

327. A secured creditor that enforces its security right is only allowed to retain what it is owed, plus reasonable enforcement costs. If there is a surplus, the secured creditor must pay the surplus to any lower-ranking competing claimant that had notified the secured creditor of its claim and its claim amount. If any balance remains, the secured creditor must pay that balance to the grantor.

328. In example 32, Bank Y enforces its security right by selling the kitchen appliances and is responsible for distributing the proceeds. Bank Y can retain ¥10,000 to cover its enforcement costs, and ¥105,000 to repay what it is owed. Bank Y then needs to pay the remaining ¥35,000 to Bank Z. Alternatively, Bank Y can pay ¥35,000 to a court or other authority for distribution in accordance with the priority rules (ML art. 79).

*Rights of the buyer*

329. As the buyer of an encumbered asset in an enforcement sale, Ms. V will take the kitchen appliances free of security rights, unless there was a security right in the kitchen appliances that had priority over Bank Y's security right (ML art. 81(3)). A lower-ranking competing claimant (for example, Bank Z) can no longer claim any right in the kitchen appliances after they have been sold to Ms. V. This protects the buyers of assets in an enforcement sale.

330. A buyer in an enforcement sale should still check whether there are any secured creditors who might have priority over the enforcing secured creditor. In example 32, if Bank Y did not take over the enforcement and instead Bank Z had sold the kitchen appliances to Ms. V, Ms. V would take the appliances free of Bank Z's security right. However, Ms. V's right in the appliance would be subject to Bank Y's security right, because Bank Y has priority over Bank Z. For this reason, a lower-ranking secured creditor would rarely dispose of encumbered assets itself, as a buyer of the enforcement sale is unlikely to take the risk of purchasing an asset that is still subject to another security right.

**I. Transition to the Model Law****1. General**

331. When a State enacts the Model Law, it needs to address transactions that were entered into before the Model Law came into force. A creditor will also need to ensure that its right continues to be effective under the Model Law. This Part provides a general overview of the rules in the Model Law that address these considerations.

**2. The Model Law applies prior security rights**

332. Before the entry into force of the Model Law, parties to a transaction may have agreed to create a right over a movable asset to secure an obligation. If that right falls within the definition of a "security right" under the Model Law (see Section I.B.2) and the Model Law would have applied to that right had the Model Law been in force when the right was created (see Sections I.B.3 and I.B.4), then that right is a "prior security right" under the Model Law and the Model Law will apply to it (ML art. 102).

333. This is the case even if the prior security right was not regarded as a security right under prior law. For example, a sale on retention-of-title terms that is entered into before the Model Law came into force will give rise to a prior security right, even if the seller's right under the transaction was not considered to be a security right under prior law.

### 3. The prior law may still apply

334. There are, however, a limited number of situations where the prior law may still apply.

335. First, the prior law applies to any matter that was the subject of proceedings brought before a court or arbitral tribunal before the Model Law came into force (ML art. 103(1)). If a secured creditor had begun to enforce a prior security right before the Model Law came into force, however, it can continue to enforce under the prior law or instead choose to enforce under the Model Law (ML art. 103(2)). A secured creditor may decide that it is more advantageous to proceed under the enforcement rules of the Model Law (see Part II.H).

336. Second, the prior law determines whether a prior security right was properly created (ML art. 104(1)). There may be instances where the prior security right was effectively created under the prior law but does not meet the creation requirements of the Model Law (ML art. 6). In that case, the prior security right will remain effective between the parties (ML art. 104(2)).

337. Third, the prior law determines the priority of a prior security right as against the rights of competing claimants, if: (i) all the competing rights arose before the entry into force of the Model Law; and (ii) their priority status has not changed since the entry into force (ML art. 106).

### 4. How to preserve the third-party effectiveness of a prior security right

338. A secured creditor with a prior security right needs to satisfy the third-party effectiveness requirements of the Model Law (ML art. 102). However, if the prior security right was effective against third parties under the prior law, it continues to be effective against third parties after the Model Law comes into force, but only for a limited time period specified by the enacting State (ML art. 105(1)(b)). If that time period is longer than the period for which the prior security right would have remained effective against third parties under the prior law, third-party effectiveness continues only until it would have ceased under the prior law (ML art. 105(1)(a)).

339. To preserve the third-party effectiveness of a prior security right, a secured creditor needs to satisfy the third-party effectiveness requirements of the Model Law. The most usual way to do this is to register a notice in the Registry. If the secured creditor does this before the third-party effectiveness ceases, its prior security right will continue to be effective against third parties from the time it was originally made effective against third parties under the prior law (ML art. 105(2)). Otherwise, its prior security right will only be effective against third parties from the time when the secured creditor meets the requirements of the Model Law (ML art. 105(3)).

### 5. An example

Example 33: A State enacts a new law based on the Model Law in 2018. The law enters into force on 1 January 2019.

Company X has a printing business. Its main asset is its printing press. In 2014, Bank Y provides financing to Company X and took security over Company X's printing press. Under the law in effect at that time, a security right in a tangible asset that remains in the possession of a grantor can be made effective against third parties indefinitely by attaching a mark to the asset that states that there is a security right in the asset. Bank Y attaches a mark to the printing press.

Company X wants to expand its operations to include delivery services. In August 2014, Company Z provides funding to Company X to purchase three vans. Company Z takes security over the vans. Under the law in effect at that time, Company Z's security right in the vans can be made effective against third parties by registering a notation in the Motor Vehicles Registry. Company Z registers the

notation in the Motor Vehicles Registry on 1 August 2015. The notation expires on 31 July 2019.

The new law does not recognize attaching a mark on the encumbered asset or a notation in the Motor Vehicles Registry as a method of achieving third-party effectiveness of a security right. Instead, a secured creditor with a prior security right is given one year after the new law comes into force to comply with the third-party effectiveness requirements, which includes registering a notice in the Registry.

340. In example 33, if Bank Y's security right in the printing press and Company Z's security right in the vans were properly created under the law in effect at the time, they remain effective between the parties after the Model Law comes into force, whether or not the parties satisfied the creation requirements of the Model Law. Under the Model Law, both security rights are prior security rights as they fall within the definition of a security right in the Model Law and the Model Law would have applied to them if it had been in force when they were created.

341. Bank Y's security right in the printing press would have remained effective against third-parties indefinitely under the prior law. However, it will expire on 31 December 2019 if Bank Y does nothing, as the new law gave Bank Y one year to comply with its third-party effectiveness requirements. If Bank Y wants to preserve the third-party effectiveness of its security right beyond 31 December 2019, it needs to register a notice in the Registry before that date.

342. The third-party effectiveness of Company Z's security right in the vans expires on 31 July 2019 under the prior law. If Company Z wants to preserve the third-party effectiveness of its security right in the vans beyond 31 July 2019, it needs to register a notice in the Registry before that date.

343. If Bank Y and Company Z registers a notice in the Registry before the respective dates, their security rights will continue to be effective against third parties from the time they were initially made effective against third parties under the prior law. If they don't, their security right will be effective against third parties from the time the notice is registered, meaning that they may rank behind another secured creditor that has registered a notice earlier.

344. If Bank Y or Company Z started to enforce its security right in 2018 and the process was not completed by 31 December 2018, it can continue to enforce under the prior law or instead proceed with the enforcement under the Model Law. If Bank Y or Company Z starts to enforce its security right after 1 January 2019, it will need to do so in accordance with the Model Law.

## **J. Issues arising from cross-border transactions**

### **1. General**

345. Much of this Guide assumes that the parties to a transaction as well as the encumbered assets are located in a State that has enacted the Model Law. This means that the Model Law applies to that transaction.

346. If a transaction is connected to more than one State (a "cross-border transaction"), however, matters become more complicated. The laws of the relevant States are unlikely to be identical. As a result, the rules governing a cross-border transaction will depend on which State's law applies. This means that the parties need to determine which State's law applies to the following issues to structure and administer their transaction properly:

- The creation of the security right;
- The third-party effectiveness of the security right;

- The priority of the security right as against competing claimants; and
- The enforcement of the security right.

347. The rules that determine which State's law governs a cross-border transaction are known as "conflict-of-laws rules". Each State has its own conflict-of-laws rules, and those rules can vary significantly. In a court proceeding involving a secured transaction, the court will apply the conflict-of-laws rules of its own State to determine which State's law it will apply to the transaction. This is also the case for insolvency proceedings. For the sake of simplicity, this Part assumes that all the relevant States have adopted the conflict-of-law rules of the Model Law.

## 2. An overview of the conflict-of-laws rules of the Model Law

### *Creation*

348. The law that determines whether a security right has been effectively created depends on whether the asset in question is tangible or intangible. For a tangible asset, the applicable law is the law of the State where the asset is located (ML art. 85). For an intangible asset, it is the law of the State where the grantor is located (ML art. 86). In both instances, the relevant location is the location at the time the security right is intended to be created (ML art. 91(1)(a)).

### *Third-party effectiveness and priority*

349. Similarly, the law that determines whether a security right in encumbered assets is effective against third parties, and the priority of that security right as against competing claimants, depends on whether the asset in question is tangible or intangible. For a tangible asset, the applicable law is the law of the State where the asset is located. For an intangible asset, it is the law of the State where the grantor is located (ML arts. 85 and 86).

350. The relevant location for third-party effectiveness and priority issues is the location of the encumbered asset or the grantor when the issue arises (ML art. 91(1)(b)). Since assets can be moved and grantors can change their location from one State to another, the law applicable to third-party effectiveness and priority can change over the course of a transaction. A secured creditor should regularly monitor the location of the encumbered asset and the grantor to ensure that the third-party-effectiveness of its security right is maintained and that its priority as against competing claimants does not change solely as a result of a change in the applicable law. In particular, if the applicable law changes as a result of a change in the location of the encumbered asset or the grantor, the secured creditor may need to take protective action, such as registering a notice in another State's Registry (ML art. 23).

### *Enforcement*

351. The law that determines the enforcement process depends on whether the encumbered asset is tangible or intangible. For a tangible asset, the applicable law is the law of the State where the asset is located when the enforcement process starts (ML art. 88(a)). For an intangible asset, it is the law of the State where the grantor is located (ML art. 88(b)).

### *Other things to bear in mind*

352. The above explanation is a very simplified overview and does not address every issue for every type of asset. For example, with respect to a security right in a bank account, the applicable law will usually be the law of the State where the bank account is maintained (ML art. 97(1), option A). The Model Law also provides special conflict-of-laws rules for security rights in the following types of assets:

- Tangible assets covered by a negotiable document (ML art. 85(2));
- Tangible assets of a type ordinarily used in more than one State (ML art. 85(3));

- Goods in transit (ML art. 85(4));
- Intellectual property (ML art. 99); and
- Non-intermediated securities (ML art. 100).

353. The location of the secured creditor does not affect which State's law applies to a secured transaction.

354. Because conflict-of-law questions can be complex, parties entering into a cross-border transaction or anticipating cross-border issues to arise in their transaction should obtain legal advice on which State's laws will apply to their transaction.

### 3. Examples

355. The following are some examples of how the conflict-of-laws rules of the Model Law work.

**Example 34:** Company X is a distributor of computers. It administers its business from an office located in State A. Company X offers computers for sale in stores located in State A and State B. Bank Y, located in State C, makes a loan to Company X. Bank Y wants to take security over the computers held as inventory in all of Company X's stores.

356. In example 34, the encumbered assets (the computers) are tangible assets. This means that the law applicable to the creation and third-party effectiveness of Bank Y's security right is the law of the State where the computers are located. For Bank Y's security right to be effective as against both Company X and third parties, Bank Y needs to satisfy the requirements in the law of State A with respect to the computers in State A, and the requirements in the law of State B with respect to the computers located in State B. The law of the State where the computers are located will apply to determine the priority of Bank Y's security right as against competing claimants in the computers

**Example 35:** Company X is a distributor of computers. It administers its business from an office located in State A. Company X sells computers on credit from stores in State A and State B to customers located in States A and B and in other States. Bank Y, located in State C, makes a loan to Company X. Bank Y wants to take security over all Company X's present and future receivables.

357. In example 35, the encumbered assets (receivables) are intangible assets. This means that the law applicable to the creation and third-party effectiveness of Bank Y's security right is the law of the State where the grantor (Company X) is located. For the purposes of the conflict-of-law rules, the location of the grantor is the State where it has its place of business (ML art. 90(a)). However, in this example, the grantor has places of business in two States (States A and B). If the grantor has places of business in more than one State, its location is the State where its central administration is exercised (State A) (ML art. 90(b)). This means that Bank Y needs to fulfil the requirements of the law of State A for its security right in the receivables to be effective as against both Company X and third parties. This is regardless of the fact that the customers of Company X may be located in States other than State A. The law of State A will apply to determine the priority of Bank Y's security right as against competing claimants in the receivables.

**Example 36:** Company X has a bank account with a bank located in State A and a bank account with a bank located in State B. Company X deposits collections from its receivables to these accounts. Bank Y, located in State C, makes a loan to Company X. Bank Y wants to take security over both bank accounts.

358. In example 36, if State C implemented option A of article 97, the law applicable to the creation and third-party effectiveness of Bank Y's security right in the bank accounts is the law of the State where the bank accounts are maintained. Bank Y will need to satisfy the requirements of the law of State A (for the bank account maintained in State A), and the law of State B (for the bank account maintained in State B), for its security right in both bank accounts to be recognized in State C as effective as against both Company X and third parties.

#### **4. Limitation on the freedom of the parties to choose the applicable law**

359. The conflict-of-laws rules of the Model Law on the law applicable to the creation, third-party effectiveness, priority and enforcement of a security right are mandatory (ML art. 3(1)). Parties cannot change the law that applies to these issues by choosing a different State's law in their agreement. However, they are free to choose the law that will apply to issues relating to the obligations between the secured creditor and the grantor (ML art. 84).

360. Parties may seek to control where court proceedings take place by inserting a "choice-of-forum" clause that purports to grant exclusive jurisdiction to the courts of a chosen State regarding disputes arising from their security agreement. Similarly, parties may insert an arbitration clause referring any dispute to arbitration. Although a choice-of-forum or arbitration clause may be effective between the secured creditor and the grantor, it is unlikely to displace the jurisdiction that may be exercised by courts in other States, if the proceedings involve the rights of third parties or if insolvency proceedings are commenced by or against the grantor in a different State.

### **III. The interaction between the Model Law and the prudential regulatory framework**

#### **A. Introduction**

361. This Chapter is addressed primarily to financial institutions that are subject to prudential regulation and supervision ("regulated financial institutions"). Typically, banks and other financial institutions that receive repayable funds, or deposits, from the public to extend loans would fall under this category. This Chapter may also provide useful guidance to national authorities exercising prudential regulatory powers and supervisory functions ("regulatory authorities").

362. The purposes of this Chapter are to assist regulated financial institutions to benefit fully from the Model Law and to emphasize the need for closer coordination between the Model Law and the national prudential regulatory framework. This coordination should be understood in the broader context of interaction of the Model Law with other domestic laws (see Section I.C.5). This Chapter does not address core policy choices underlying the prudential regulatory framework, whether national or international.

363. Capital adequacy standards, also referred to as capital requirements, for regulated financial institutions are a key component of a State's prudential regulatory framework. They typically require regulated financial institutions to control their exposure to various risks and to maintain adequate capital to absorb losses, taking into account both the soundness of the individual institutions and the stability of the financial system as a whole. Capital adequacy standards typically include specific requirements to cover operational risk, market risk and credit risk, with the focus on credit risk.

364. Capital requirements are primarily concerned with the absorption of unexpected losses.<sup>2</sup> For this purpose, they define the minimum amount of capital (referred to as “regulatory capital”) that regulated financial institutions are required to maintain at any point in time in relation to their exposure to risks. Minimum regulatory capital requirements are expressed as a ratio of: (i) the financial institution’s own funds, primarily composed of shareholders’ equity and long-term subordinated debt; and (ii) the risk-weighted assets of the financial institution. This means that the required amount of capital is not fixed in absolute terms but is set relative to both the balance sheet size of the regulated financial institution and the riskiness of its assets. In practice, for every financing transaction, such as a loan, regulated financial institutions calculate a capital charge that reflects the level of risk of that transaction (in particular, the credit risk). Loans with a higher level of risk are subject to higher capital charges. For regulated financial institutions, this means that when the exposure is riskier, a greater amount of regulatory capital is required.

365. National statutory or regulatory laws defining capital requirements determine the risk weights of different classes of assets and set the capital adequacy ratios that regulated financial institutions must meet. Capital requirements do not prevent regulated financial institutions from extending loans. If a regulated financial institution extends a loan, it must either increase the amount of its own funds or reduce its exposure to credit risk, for instance, through the adoption of a risk mitigation technique.

366. In addition to regulatory capital, national regulatory authorities prescribe requirements to manage expected losses. These rules, often referred to as provisioning requirements or loan loss provisioning requirements, establish procedures to assess and monitor expected losses associated with a given credit facility in order to set aside reserves, or allowances. These requirements prescribe categories for the classification of loans depending on whether they are performing, underperforming, or non-performing and ensure that allowances increase as the credit facility deteriorates. Regulated financial institutions are typically required to assess, in a forward-looking manner, the likelihood of incurring losses on each loan to determine the appropriate regulatory category and to set aside the corresponding provisions. In this process, regulated financial institutions may take into account the loss absorption capacity provided by collateral.

367. International efforts have been made to ensure that prudential regulation of financial institutions is coordinated and respects international minimum standards. The Basel Committee on Banking Supervision (BCBS) is one of the organizations entrusted with the task of establishing international standards on the capital requirements contained in the Basel Capital Accords. In addition, there are international accounting or financial reporting standards that may be applied in conjunction with prudential regulation.

368. Before the enactment of the Model Law, there may not have been sufficient legal certainty for regulated financial institutions to take into account security rights in movable assets when calculating loan loss provisioning and regulatory capital. The Model Law (coupled with the Registry) provides the necessary legal certainty, predictability, and transparency for the sound management of credit risk with respect to expected and unexpected losses. Through further coordination between the Model Law and prudential regulation, it might be permissible for regulated financial institutions to take into account security rights in movable assets when determining provisions and capital charges.

---

<sup>2</sup> Expected loss refers to a loss that is statistically expected to occur on an exposure within a given period, for example, one year from the loan. Unexpected loss refers to a loss that is greater than what is expected from a statistical standpoint within a given period. Expected and unexpected losses are typically estimated through models based on historical observations to determine frequency and impact of relevant credit events.

## B. Key terminology

369. Terminology used by regulated financial institutions, national regulatory authorities and the BCBS may differ from that used in the Model Law. As this Chapter is addressed primarily to regulated financial institutions, this section illustrates how some of the terms are used in this Chapter.

Collateralized transactions	One of the techniques that regulated financial institutions may adopt to mitigate credit risk.  They encompass any consensual arrangement under which the exposure to credit risk is covered, fully or partially, by a right in an encumbered asset (including a security right under the Model Law).
Credit risk mitigation	Various techniques, such as collateralized transactions, rights of set-off, and guarantees, used by regulated financial institutions to reduce their exposure to credit risk.  When specific requisites are met, credit risk mitigation techniques could be taken into account in the calculation of capital charges.
Eligible collateral	Assets that are encumbered by a security right and may be taken into account for the calculation of capital charges, subject to certain conditions being met.
Eligible financial receivables	Claims of less than or equal to one year (including debts arising from sale of goods or provision of services in commercial transactions and debts owed by non-affiliated parties not related to the sale of goods or services in a commercial transaction) that may be taken into account for the calculation of capital charges.  They do not encompass claims arising from securitizations or credit derivatives.
Physical collateral	Tangible movable assets such as machinery, raw materials and motor vehicles, with the exception of commodities and aircraft (which typically belong to the category of specialized lending exposures).
Specialized lending exposures	Exposures with specific characteristics and subject to a different regime for calculating capital charges, including commodities finance and object finance.

## C. Enhancing coordination between the Model Law and national prudential regulation

370. The primary objective of the Model Law is to increase access to credit at a reasonable cost, through the establishment of a modern secured transaction regime facilitating, among others, the creation and enforcement of security rights in movable assets. Under the Model Law, financial institutions may acquire a security right to reduce their exposure to credit risk, which should, in turn, enable them to extend more credit. The Model Law does so by covering a wide range of assets and permitting parties to tailor their arrangement to fit their needs and expectations (see Part I.B).

371. National prudential regulation generally takes into account collateral in mitigating the credit exposures of financial institutions. However, the lack of coordination between capital requirements and the Model Law could inadvertently

limit the incentives that regulated financial institutions have to extend credit secured by rights over certain movable assets. In addition, and as further illustrated in this Chapter, certain movable assets, such as receivables, inventory, or equipment, might not necessarily qualify as eligible collateral. In these circumstances, loans would be treated as unsecured for prudential regulatory purposes.

#### *General prerequisites*

372. For a collateralized transaction to be recognized as an eligible credit risk mitigation for calculating capital requirements and potentially reducing capital charges, some requisites need to be met. In particular, following international standards on capital requirements, it is essential that there be legal certainty with respect to security rights and that they can be efficiently enforced upon default of the debtor.

373. Regulated financial institutions are usually required to demonstrate two pre-conditions with respect to any collateralized transaction. First, the security right must be the highest-ranking in priority apart from preferential claims. Chapter V of the Model Law provides a comprehensive and coherent set of priority rules which regulated financial institutions can rely on to identify and establish the priority of their security rights as against competing claimants (see Part II.G). Furthermore, article 35 of the Model Law provides that the priority of a security right continues unimpaired in the insolvency of the grantor, except as otherwise provided under insolvency law. Second, the security right must be enforceable in a timely manner. Chapter VII of the Model Law provides rules to facilitate efficient and expeditious enforcement of a security right (including expeditious relief as provided in article 74, see Part II.H). In short, the Model Law provides mechanisms under which regulated financial institutions can meet the general prerequisites in capital requirements for the calculation of capital charges.

374. Financial institutions are also required to develop sound internal procedures to control, monitor, and report any risk associated with the collateral including those that could potentially compromise the effectiveness of credit risk mitigation. Moreover, they are usually required to establish and document internal procedures for the expeditious enforcement of security rights. To this end, it is important for regulated financial institutions to become familiar with the relevant provisions of the Model Law, in particular, with the steps necessary to enforce their security right (see Part II.H). They should also adopt policies to ensure that the priority of their security right is not undermined, for instance, by the inadvertent lapse of the effectiveness of a registration of a notice (see Section II.E.8).

375. If a collateralized transaction involves connections with more than one State and thus may be governed by laws of more than one State, financial institutions would need to ensure that their security rights are adequately protected (mainly their priority and enforceability) under those laws. Provisions in chapter VIII of the Model Law provide clarity on the applicable law, which financial institutions can rely on (see Part II.J).

#### *Capital requirements*

376. There are various methodologies to assess credit risk and to calculate corresponding capital charges. Under the standardized approach, risk weights are set out in national statutory or regulatory laws, which also list eligible collateral. Reflecting international standards, the list of eligible collateral typically includes only highly liquid assets, such as funds held in deposit accounts with the lending financial institution, gold, and intermediated securities. The rights of regulated financial institutions to reimbursement of their undertakings in the form of commercial letters of credit might also reduce capital charges if certain conditions are met. Movable assets of businesses (such as receivables, inventory, agricultural products, and equipment) are, however, typically not included in the list of eligible collateral under

the standardized approach. This means that they are not normally taken into account when capital charges are calculated, although they might be taken into account for provisioning purposes.

377. Subject to certain minimum conditions and disclosure requirements, regulated financial institutions may be permitted by national regulators to use more sophisticated methodologies. These methodologies are based on internal models and are commonly referred to as internal ratings-based (IRB) approaches. When authorized to use one of these approaches, regulated financial institutions would be able to rely on their own internal estimates of risk components in determining the capital requirement for a given exposure. The risk components include measures of the probability of default, loss given default, the exposure at default, and effective maturity. In some cases, regulated financial institutions are required to use a value established by national regulatory authorities, rather than an internal estimate for one or more of the risk components. Regulated financial institutions using these approaches are allowed to recognize additional forms of collateral, such as financial receivables and physical collateral, subject to certain conditions being met. For regulated financial institutions with approval to use their own estimated values of loss given default, the estimate must be grounded in historical recovery rates and must not solely be based on the collateral's estimated market value. IRB approaches tend to be applied by regulated financial institutions that are familiar with more sophisticated techniques for risk management and have sufficient and reliable historical data.

378. The process of regulated financial institution obtaining authorization to use IRB approaches is generally set out in national statutory or regulatory laws. In line with international standards, authorization requires a thorough supervisory examination of the risk-management practices of the regulated financial institution as well as scrutiny of the reliability of internal models. Furthermore, regulated financial institutions are required to implement sound internal procedures to assess and manage credit risk. Regulatory authorities may establish additional requirements to foster the soundness and the reliability of the models. Regulatory authorities may authorize or reject a request for authorization to use IRB approaches and may also withdraw any previous authorization.

*Financial receivables and physical collateral as eligible collateral*

379. When regulated financial institutions obtain authorization to use IRB approaches, they can take into account financial receivables and physical collateral for credit risk mitigation purposes. To do so, they would need to comply with several criteria set out in the capital requirements.

380. For financial receivables to be considered as eligible collateral, regulated financial institutions are typically required to:

- Have the right to collect or transfer the receivables without any consent of the debtor of the receivable (see ML arts. 59, 78, 82 and 83 and Section II.H.6);
- Have a right to proceeds (see ML art. 10 and Section II.A.12);
- Ensure that the security right in the receivables is effective against third parties;
- Ensure that they have priority over competing claimants;
- Establish lending policies determining which financial receivables should be taken into account when setting the amount of available credit;
- Establish processes for collecting receivables in situations of distress; and
- Implement sound processes to manage the credit risk associated with receivables (for example, performing due diligence on the borrower and the industry, establishing mechanisms to set advance rates, adopting policies ensuring that the receivables are diversified and not unduly correlated with the borrower, and ensuring that the receivables are continuously monitored).

381. For physical collateral to be considered as eligible collateral, regulated financial institutions are typically required to:

- Demonstrate the existence of liquid markets to dispose of the physical collateral in a timely manner;
- Ensure that transparent and publicly available prices are available for estimating the value of the physical collateral in case of default;
- Have the highest-ranking priority in the physical collateral as well as its proceeds;
- Include in the loan agreement a detailed description of the physical collateral and the right of the institution to inspect the collateral whenever deemed necessary;
- Indicate the types of assets that would be accepted as physical collateral;
- Establish internal credit policies for auditing and supervisory examination purposes; and
- Regularly monitor the physical collateral and periodically revalue it to take into account any deterioration or obsolescence.

382. In addition to the regulatory regime for different types of collateral, national regulatory authorities may authorize regulated financial institutions to classify certain loans as specialized lending exposures, which are subject to a different regime for the calculation of capital charges. For loans to be classified as specialized lending exposures, they should generally satisfy specific criteria:

- The lender should have a substantial degree of control over the assets and the income that they generate;
- The exposure should be to a borrower which has the sole purpose of financing and/or operating the assets; and
- The primary source of repayment should be the income generated by the assets being financed, rather than by the independent capacity of the borrower.

383. Specialized lending exposures are typically divided into different sub-classes. Among the sub-classes, commodities finance and object finance are particularly important in the context of secured transactions.

384. Commodities finance is generally understood as structured short-term lending secured by inventories or receivables of exchange-traded commodities (such as crude oil, metals, or crops). The loan will be repaid solely from the proceeds of the sale of the commodities rather than from other business activities of the borrower. Depending on the nature of the inventory and receivables, a transaction secured by inventory or receivables may be considered either as a corporate exposure, for which credit risk is mitigated through eligible physical collateral, or as a specialized lending exposure in the form of commodities finance.

385. Object finance refers to the financing of the acquisition of a high-value asset (for example, ships, aircraft, satellites, and railcars) where the repayment of the loan depends on the cash flows generated by the asset. The Model Law might not necessarily apply to security rights over such assets (ML art. 1(3)(e), see Section II.E.11), for example, where security rights over such assets may be governed by the international legal framework established by the Convention on International Interests in Mobile Equipment (Cape Town Convention) and its Protocols, or by other domestic laws.

386. While coordination efforts between the Model Law and prudential regulation may result in reduced capital charges, that is not the sole purpose of coordination. It is also to promote sound risk management that is based on a thorough assessment of risks related to collateralized transactions. The result of such coordination informs

the design of a legal and regulatory framework that incentivizes a prudent and inclusive credit environment

## Annexes

### Annex I

#### The Model Law and work by UNCITRAL in the area of secured transactions

UNCITRAL has prepared a number of instruments in the field of security interests. These instruments may help readers to better understand the policies and principles underlying the Model Law.

United Nations Convention on the Assignment of Receivables in International Trade (2001)	<ul style="list-style-type: none"> <li>• Provides uniform rules on the assignment of international receivables with an aim to enhance availability of credit on the basis of such receivables</li> <li>• Includes autonomous conflict-of-laws rules</li> </ul>
Legislative Guide on Secured Transactions (2007)	<ul style="list-style-type: none"> <li>• Provides a broad policy framework for an effective secured transactions law governing security rights in movable assets with an aim to enhance the availability of affordable credit</li> <li>• Includes commentary and legislative recommendations to assist States in their secured transactions law reform</li> </ul>
Legislative Guide on Secured Transactions: Supplement on Security Rights in Intellectual Property (2010)	<ul style="list-style-type: none"> <li>• Provides guidance to facilitate extension of secured credit to intellectual property right holders using such rights as encumbered asset</li> <li>• Includes commentary and recommendations dealing specifically with security rights in intellectual property</li> </ul>
Guide on the Implementation of a Security Rights Registry (2013)	<ul style="list-style-type: none"> <li>• Provides commentary and recommendations on the establishment and operation of an efficient and accessible security rights registry, increasing transparency and certainty of security rights</li> </ul>
UNCITRAL Model Law on Secured Transactions (2016)	<ul style="list-style-type: none"> <li>• Provides a comprehensive set of legislative provisions for enactment by States to deal with security interests in all types of movable assets</li> <li>• Includes Model Registry Provisions dealing with the registration of notices in a publicly accessible security rights registry</li> </ul>
Guide to the Enactment of the Model Law (2017)	<ul style="list-style-type: none"> <li>• Provides guidance to States in their enactment of the Model Law</li> <li>• Explains briefly the thrust of each provision of the Model Law and its relationship with the corresponding recommendations of the Legislative Guide on Secured Transactions</li> </ul>

## Annex II

### Glossary

To the extent possible, this Guide uses terms as defined in article 2 of the Model Law. The following provides clarification on how some of the key terms are used in this Guide.

Term	What it broadly means
Acquisition security right	<p>A security right which secures an obligation owed by the grantor when and to the extent the credit was used to finance the acquisition of the encumbered asset (see examples 5A to 5D).</p> <p>For example;</p> <ul style="list-style-type: none"> <li>• A security right in an asset to secure a buyer’s obligation under the loan, which is provided to allow the buyer to purchase the asset;</li> <li>• A seller’s right in an asset that it sells to the buyer while retaining title to the asset to secure the obligation of the buyer to pay the purchase amount; and</li> <li>• A lessor’s rights in an asset that it leases to a lessee under a finance lease arrangement.</li> </ul>
All-asset security right	<p>A security right created over all present and future assets of the grantor (see example 4).</p>
Borrowing base	<p>An amount that a creditor is willing to loan based on the value of the encumbered assets provided by the grantor (see example 20). This typically involves multiplying a discount factor by each type of asset, for example, 60% of the borrower’s accounts may be accepted as a borrowing base.</p>
Competing claimant	<p>A creditor of a grantor or other person with rights in an encumbered asset that may be in competition with the rights of a secured creditor in the same encumbered asset.</p> <p>For example;</p> <ul style="list-style-type: none"> <li>• Another secured creditor with a security right in the same asset.</li> <li>• A judgment creditor taking steps to acquire a right in the encumbered asset.</li> <li>• An insolvency representative in respect of the grantor.</li> <li>• A buyer or other transferee of the encumbered asset.</li> </ul>
Debtor	<p>A person who owes payment or other performance of the secured obligation.</p> <p>If a person obtains a loan and arranges for its obligations under the loan arrangement to be secured by an asset of another person, the debtor and the grantor would be different.</p> <p>The term “debtor of the receivable” is used in this Guide, which has a different meaning. A debtor of the receivable is a person that owes payment of a receivable, which is provided as security (see examples 9, 10 and 29).</p>
Default	<p>The failure of a debtor to pay or otherwise perform a secured obligation. It may also include other events that the grantor and the secured creditor agree as constituting default (see Section II.D.3).</p> <p>For example:</p>

	<ul style="list-style-type: none"> <li>• The insolvency of the grantor;</li> <li>• A third party taking steps to seize or enforce against any of the encumbered asset; and</li> <li>• The entry of a judgment against the grantor above a specified amount.</li> </ul>
Encumbered asset	<p>A movable asset that is provided to secure an obligation. It is also often referred to as “collateral”.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• An equipment that a distributor sells while retaining title to secure the payment of the purchase amount;</li> <li>• A car that is being leased under a finance lease;</li> <li>• An intellectual property licence that the licensee has provided as security;</li> <li>• A receivable that is transferred by agreement, whether or not the transfer is for security purposes (see example 9).</li> </ul>
Equipment	<p>A tangible asset other than inventory or consumer goods that is primarily used by a grantor in the operation of its business.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• A printing press owned by a printing business; and</li> <li>• A shop’s cash register.</li> </ul>
Future asset	<p>A movable asset which does not yet exist or which the grantor does not yet have rights in or the power to encumber at the time the security agreement is entered into.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• A computer that a grantor may purchase;</li> <li>• Products that the grantor may manufacture; and</li> <li>• Receivables that the grantor may generate after the security agreement is entered into.</li> </ul>
Grantor	<p>A person who creates a security right to secure an obligation that it owes, or that is owed by another person.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• A company that gives a security right over all its assets to secure a revolving loan (see example 10);</li> <li>• A buyer of goods on retention-of-title terms (see example 5A);</li> <li>• A lessee of goods under a finance lease (see example 5D);</li> <li>• A transferor of a receivable, whether or not the transfer is for security purposes (see example 9); and</li> <li>• A buyer or other transferee of an encumbered asset that acquires its rights subject to the security right (see example 19 and 22).</li> </ul>
Inventory	<p>Tangible assets that are held for sale or lease in the ordinary course of business, including raw materials and work in process.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• Paper used by a printing business to print newspapers for its customers; and</li> <li>• Products available for sale in a shop.</li> </ul>
Movable asset	<p>A tangible or intangible asset, which is not immovable property.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• Inventory</li> <li>• Equipment</li> </ul>

	<ul style="list-style-type: none"> <li>• Receivables</li> <li>• Bank accounts</li> <li>• All types of intellectual property</li> </ul>
Proceeds	<p>Anything that is received in respect of an encumbered asset.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• The proceeds of the sale of an asset;</li> <li>• Insurance proceeds, if the asset is damaged, lost or destroyed;</li> <li>• Warranty claims, if the asset is defective;</li> <li>• Rent payments, if the asset is leased;</li> <li>• Interest payments, if the asset is an interest-bearing debt claim; and</li> <li>• Dividend payments, if the asset is a share in a company.</li> </ul> <p>It also includes proceeds of proceeds. For example, if an asset is sold for cash, and the cash is used to buy something else.</p>
Priority	<p>The right of a person in an encumbered asset that ranks ahead of the right of a competing claimant.</p>
Receivable	<p>A right to payment of money excluding a right to payment evidenced by a negotiable instrument, a right to payment of funds credited to a bank account and a right to payment under non-intermediated securities.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• Money owing to a distribution business that sells assets to its customers on credit terms.</li> <li>• Money owing to a plumber who has rendered an account to a customer but not been paid yet.</li> </ul>
Secured creditor	<p>A person who has a security right. For ease of reference, the term is used in this Guide to include prospective secured creditors, in other words those that intend to take security over a movable asset.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• A lender that takes a security right over all of the assets of a company as security for a revolving loan;</li> <li>• A seller of drilling equipment on retention-of-title terms;</li> <li>• A lessor under a finance lease; and</li> <li>• A transferee under a transfer of a receivable by agreement, whether or not the transfer is for security purposes.</li> </ul>
Security agreement	<p>An agreement between a grantor and a secured creditor to create a security right, whether or not the parties call it a security agreement.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• An agreement for the sale of a tangible asset on retention-of-title terms; and</li> <li>• An agreement for the transfer of a receivable whether or not the transfer is for security purposes.</li> </ul>
Security right	<p>A property right in a movable asset, created by a security agreement, that secures payment or other performance of a secured obligation. Any right that serves a security purpose, whether or not the parties have denominated as a security right, and regardless of the type of asset, the status of the grantor or secured creditor, or the nature of the secured obligation.</p> <p>For example:</p> <ul style="list-style-type: none"> <li>• The right of a seller of a tangible asset on retention-of-title terms;</li> </ul>

---

	<ul style="list-style-type: none"><li>• The right of a lessor under a finance lease; and</li><li>• The right of a transferee under a transfer of a receivable by agreement, whether or not the transfer is for security purposes.</li></ul>
--	---

## Annex III

### Sample Diligence Questionnaire

In exercising due diligence, a secured creditor will usually ask the grantor to complete a questionnaire that lists some essential information to protect the security rights in the assets to be encumbered. The following “Sample Diligence Questionnaire”, though not intending to be the sole standard or model, provides an example of such a questionnaire. This sample must be adjusted according to the nature of the transaction, the parties involved and the type of assets to be encumbered. It is advisable to request similar information from other co-borrowers and guarantors.

While the Sample Diligence Questionnaire solicits a wide range of information required for more sophisticated types of secured transactions, a simpler questionnaire may be used for more general types of secured transactions, such as those in which the grantor is a micro-enterprise.

**TO [GRANTOR],**

The undersigned, [SECURED CREDITOR] (the “Company”) hereby represents and warrants to you as follows:

**1. General information relating to the Company**

- (a) The name of the Company as it appears in its current organizational documents: [\_\_\_\_\_]
- (b) Identification number: [\_\_\_\_\_]
- (c) Tax identification number: [\_\_\_\_\_]
- (d) Jurisdiction of incorporation: [\_\_\_\_\_]
- (e) Other jurisdictions where the Company is duly qualified to conduct business: [\_\_\_\_\_]
- (f) All other names (including fictitious, trade and similar names) currently being used by the Company or used in the past: [\_\_\_\_\_]
- (g) Names and addresses of all entities which have been merged into the Company: [\_\_\_\_\_]
- (h) Names and addresses of all entities from whom the Company has acquired any movable asset through a transaction not in the ordinary course of that entity’s business along with the date of acquisition and the type of movable asset: [\_\_\_\_\_]

\* Attached are copies of all organizational and related documents of the Company.

**2. Location of the Company**

- (a) Current address of the place of central administration of the Company: [\_\_\_\_\_]
- (b) Addresses of other locations where the Company maintains or stores any inventory, equipment or other assets: [\_\_\_\_\_]

**3. Assets of the Company**

- (a) Types of assets with a detailed schedule describing each asset and their location

Motor vehicles	Yes <input type="checkbox"/> No <input type="checkbox"/>
Equipment	Yes <input type="checkbox"/> No <input type="checkbox"/>
Inventory (raw material and finished goods)	Yes <input type="checkbox"/> No <input type="checkbox"/>
Receivables	Yes <input type="checkbox"/> No <input type="checkbox"/>
Registered copyrights, patents, trademarks and relevant applications	Yes <input type="checkbox"/> No <input type="checkbox"/>
Unregistered copyrights	Yes <input type="checkbox"/> No <input type="checkbox"/>
Licenses to use trademarks, patents and copyrights	Yes <input type="checkbox"/> No <input type="checkbox"/>
Promissory notes and other negotiable instruments	Yes <input type="checkbox"/> No <input type="checkbox"/>
Equipment leased by the Company	Yes <input type="checkbox"/> No <input type="checkbox"/>
	Yes <input type="checkbox"/> No <input type="checkbox"/>

	Yes <input type="checkbox"/> No <input type="checkbox"/>
	Yes <input type="checkbox"/> No <input type="checkbox"/>

(b) Banks and other financial institutions at which the Company maintains a deposit account, securities account or commodity account:

Name of bank	Address	Account information

#### 4. Material contracts

[A list of material contracts which the Company is a party]

\* Attached are copies of:

- loan and other financing agreements, inter-creditor agreements and guarantees with a schedule of all outstanding obligations thereunder or in respect thereof
- mortgages, pledges and security agreements
- lease agreements relating to real property
- agreements regarding mergers and acquisitions, whether or not consummated
- all other contracts in which the Company has an interest

#### 5. Encumbrances

[A list of property subject to liens or encumbrances]

Name of Holder of Lien/Encumbrance	Description of property

#### 6. Potential or pending disputes<sup>1</sup>

A list of pending disputes in which the Company is involved, including:

- pending and potential arbitration, litigation, or claims against the Company for an indefinite amount or in excess of \$50,000 for each case;
- administrative, governmental or regulatory investigations or proceedings; and
- claims other than claims on accounts receivable, which the Company is asserting or intends to assert, and in which the potential recovery exceeds \$50,000 for each case.

#### 7. Affiliate transactions<sup>2</sup>

[A list of transactions between the Company and its affiliates]

\* Attached are copies of any agreements, including any tax-sharing agreements and loan agreements with the affiliates.

#### 8. Tax assessments

(a) Tax assessments currently outstanding and unpaid by the Company

Tax authority	Description	Amount due

<sup>1</sup> An analysis of pending or potential claims can yield valuable information as to potential financial risks to which the company may be exposed, as well as how the company conducts its business. A lender may also wish to consult with the bankruptcy and insolvency officials to ensure that insolvency proceedings have not been commenced.

<sup>2</sup> It would be important to verify that such transactions are conducted on an arms-length basis, rather than a potential source of self-dealing by the company.

(b) Any pending audits or potential disputes with tax authorities: [\_\_\_\_\_]

\* Attached are copies of the Company’s tax filings for the past five years.

**9. Employee benefits**

[A list of benefits provided by the Company to its employees]

\* Attached are copies of the employee pension benefit plan, revenue or profit-sharing plan, multi-employer plan or another pension.

**10. Insurance**

Insurer and policy number	Description of insurance policy	Type of coverage and limitations

**11. Directors, managers and other officers of the Company**

Title	Name

**12. Miscellaneous**

- Indebtedness: [List of any current indebtedness of the Company that is to be paid off at the closing of the loan, including each creditor’s name, a contact person and contact details, and the approximate amount of such indebtedness]

\* Attached are copies of the documentation for the Company’s existing indebtedness that will remain in place after the closing of the loans.

- Necessary consents: [List of any consents or approvals required in connection with the closing of the loans]
- Regulatory and licensing matters: [Any regulatory/licensing compliance required of the Company due to the specific nature of its business and any notifications received by the Company for non-compliance with applicable law or regulation]

**13. Legal counsel representing the Company**

Name of attorney	Affiliation	Telephone	Email

The Company agrees to advise you of any change or modification to any of the foregoing information or any supplemental information provided on the exhibits or attachments hereto and, until such notice is received by you, you shall be entitled to rely on the information contained herein and on the supplemental information provided on such exhibits and attachments and presume that all such information is true, correct and complete.

18 October 2019

[Name of the Grantor]

By:

Name:

Title:

Email:

Phone: \_\_\_\_\_

## Annex IV

### Sample security agreements

#### A. A sample security agreement creating a security right in a specific asset

[Name and address of the grantor], [any other description of the grantor, including its place of central administration, type of entity and applicable law], agrees to grant a security right in [description of the encumbered asset (for example, located at ..., manufactured by ..., with serial number ...)] in favour of [name and address of the secured creditor] to secure its obligation to pay [amount] under [description of the agreement, from which the obligation arises, including the date the agreement was entered into]

[date of the agreement]

[Name of the grantor]  
[Signature of the grantor]

[Name of the secured creditor]  
[Signature of the secured creditor]

#### B. Sample security agreement covering all assets of the grantor

Depending on other applicable laws of the enacting State, some of the provisions in the sample security agreement below might not be valid.

#### SECURITY AGREEMENT

between

[Name and address of the grantor] (the “Grantor”)

and

[Name and address of the secured creditor] (the “Secured Creditor”)

##### Preamble

A. The Secured Creditor has agreed to make available to the Grantor a line of credit to finance the operations of the Grantor pursuant to a credit agreement<sup>1</sup> dated 18 October 2019 (as same may be amended, supplemented or restated from time to time, the “Credit Agreement”).

B. The execution of this agreement is a condition to the extension of credit by the Secured Creditor to the Grantor under that credit agreement.

##### 1. Definitions

In this agreement:

- (a) Each term which is defined in the Model Law has the meaning given to it in the Model Law;
- (b) “Event of Default” means (i) any event that constitutes an “event of default” under the Credit Agreement, and (ii) any failure by the Grantor to comply with any of its obligations under this agreement;

...

<sup>1</sup> The term “credit agreement” is used as a generic term to describe the agreement under which credit may be extended by the creditor. Other terms may be used depending on the nature of the transaction or local practices.

## **2. Creation of the security right and secured obligations**

### **2.1 Creation of the security right**

The Grantor creates in favour of the Secured Creditor a security right in all of the Grantor's present and future assets which are within the following categories of assets<sup>2</sup> (the "Encumbered Assets"):

- (a) Inventory;
- (b) Receivables;
- (c) Equipment;
- (d) Funds credited to a bank account;
- (e) Negotiable documents, including without limitation, bills of lading and warehouse receipts;
- (f) Negotiable instruments, including without limitation, bills of exchange, cheques and promissory notes;
- (g) Intellectual property and rights as licensee;
- (h) ...
- (i) To the extent not listed above, all proceeds<sup>3</sup> and products of all of the foregoing.

### **2.2 Secured Obligations**

The security right hereby created secures all present and future obligations of the Grantor to the Secured Creditor under or contemplated by the Credit Agreement and this agreement ("Obligations").

## **3. Representations of the Grantor<sup>4</sup>**

### **3.1 Location of certain Encumbered Assets**

- (a) The inventory and the equipment of the Grantor are and will be held or used by the Grantor at all times in State A and, unless the Grantor notifies the Secured Creditor of a change, at the addresses listed in the Annex to this agreement;
- (b) The billing addresses of the debtors of the receivables owed or to be owed to the Grantor are and will be at all times in State A, unless the Grantor notifies the Secured Creditor of a change by a notice specifying other State(s) in which debtors of these receivable have billing addresses;
- (c) The bank accounts of the Grantor are and will be held at all times at branches of banks in State A, and, unless the Grantor notifies the Secured Creditor of a change, at the addresses listed in the Annex to this agreement. The account agreements relating to these bank accounts are and will be governed by the relevant law of the State in which the applicable branch is located and do not and will not refer to another law for matters relevant to this agreement.<sup>5</sup>

### **3.2 Location and name of the Grantor**

- (a) The registered office and the place of central administration of the Grantor are and will be located at all times in State A;
- (b) The Grantor's exact name and the State of constitution are as specified on the first page of this agreement. The Grantor will not change its State of constitution without the prior written consent of the Secured Creditor and will not change its name without giving to Secured Creditor a thirty (30) day prior notice of the change.

## **4. Authorizations relating to the Encumbered Assets**

### **4.1 Registrations**

The Grantor authorizes the Secured Creditor to register any notice and to take any other action necessary or useful to make the Secured Creditor's security right effective against third parties by registration.

### **4.2 Inspection and copies**

- (a) The Secured Creditor may inspect the Encumbered Assets and the documents or records evidencing same and for such purposes may enter into the Grantor's premises, upon giving prior reasonable notice to the Grantor;
- (b) At the request of the Secured Creditor, the Grantor will furnish to the Secured Creditor copies of the invoices, contracts and other documents evidencing its receivables.

#### 4.3 Dealings with Encumbered Assets

- (a) Until the Secured Creditor notifies the Grantor that an Event of Default has occurred, the Grantor may sell, lease, license or otherwise dispose of its inventory and documents of title, collect its receivables and negotiable instruments and dispose of worn-out or obsolete equipment, in each case, in the ordinary course of its business;
- (b) The Grantor will not grant any security right in the Encumbered Assets and, except as permitted by paragraph (a), will not sell, lease, license or otherwise dispose of the Encumbered Assets;<sup>6</sup>
- (c) Unless otherwise agreed between the parties, the Secured Creditor may at any time notify the debtors of the Grantor's receivables of the existence of its security right. However, a notification given prior to the occurrence of an Event of Default will authorize the debtors to make their payments to the Grantor until otherwise instructed by the Secured Creditor following the occurrence of an Event of Default.<sup>7</sup>

### 5. Undertakings relating to the Encumbered Assets

#### 5.1 Movable assets

The Grantor undertakes that the Encumbered Assets will remain movable assets at all times and will not be physically attached to immovable property.

#### 5.2 Effectiveness of the security right

The Grantor will take all actions and execute all documents reasonably required by the Secured Creditor for the Secured Creditor's security right to be at all times enforceable and effective and enjoy priority against third parties in all jurisdictions where the Encumbered Assets may be located or where the security right may be enforced.

#### 5.3 Bank accounts

The Grantor will take all steps required for the Secured Creditor's security right to be made effective against third parties through a control agreement with respect to all funds credited to a bank account held with a bank other than with the Secured Creditor.<sup>8</sup>

### 6. Enforcement

#### 6.1 Rights after an Event of Default

After the occurrence of an Event of Default and to the extent same is continuing:

- (a) the Secured Creditor may enforce its security right and exercise all rights of a secured creditor under the Model Law and any other applicable law;
- (b) the Secured Creditor may also, subject to any mandatory provision of applicable law:
  - (i) take possession, use, operate, administer and sell, lease, license or otherwise dispose of any of the Encumbered Assets, in each case, on terms and conditions it deems appropriate;
  - (ii) collect the Grantor's receivables and negotiable instruments, compromise or transact with the debtors of these receivables and instruments, and grant discharges to them; and

<sup>2</sup> When all present and future assets of the Grantor are intended to be encumbered, the list would not be necessary. The list is provided as an option when the intent of the parties is to limit the security right to certain categories of assets.

<sup>3</sup> While a security right in an encumbered asset extends to its identifiable proceeds, the parties may wish to include such proceeds as part of the original encumbered asset.

<sup>4</sup> This security agreement only includes representations on facts that permit a secured creditor to identify the State whose law will apply to the creation, effectiveness against third parties and priority of a security right. Among other things, the information contained in this section will assist the secured creditor to determine where a registration needs to be made.

<sup>5</sup> This is to ensure the identification of the applicable law under article 97 of the Model Law.

<sup>6</sup> This prohibition is a contractual obligation and is not binding upon third parties. For example, a third party who purchases an encumbered asset may acquire it free of the security right in certain circumstances.

<sup>7</sup> Under the Model Law, a notification to the debtor of a receivable may be given at any time. However, the parties will often include in their security agreement the authorization provided in the second sentence (see ML art. 63(2)).

<sup>8</sup> If funds were deposited with the Secured Creditor, then it will benefit from automatic third-party effectiveness. The Model Law also recognizes control agreements as a method of achieving third-party effectiveness (see ML art. 25).

(iii) take all other actions necessary or useful for the purpose of realizing on the Encumbered Assets, including without limitation completing the manufacture of inventory and purchasing raw materials.

#### 6.2 Access to the Grantor's premises

The Grantor permits the Secured Creditor to enter into and use the premises where the Encumbered Assets are located for the purposes of the exercise of the Secured Creditor's enforcement rights.<sup>9</sup>

#### 6.3 Manner of enforcement

The enforcement rights may be exercised on all of the Encumbered Assets taken as a whole or separately in respect of any part of them.

#### 6.4 Reimbursement of expenses

The Grantor will reimburse the Secured Creditor upon demand for all costs, fees and other expenses incurred by the Secured Creditor in the exercise of its rights (including without limitation in the enforcement of its security right), with interest at annual rate of \*\*%.

### 7. General Provisions

#### 7.1 Additional and continuing security

The security right created by this agreement is in addition to (and not in substitution for) any other security held by the Secured Creditor and is a continuing security that will subsist notwithstanding the payment from time to time, in whole or in part, of any of the Obligations. However, this security right will extinguish when the commitment to extend credit under the Credit Agreement has terminated and all Obligations have been satisfied in full.

#### 7.2 Collections

Any sum collected by the Secured Creditor from the Encumbered Assets prior to all the Obligations becoming due may be held by the Secured Creditor as Encumbered Assets.

#### 7.3 Other recourses

The exercise by the Secured Creditor of any right will not preclude the Secured Creditor from exercising any other right provided in this agreement or by law, and all the rights of the Secured Creditor are cumulative and not alternative. The Secured Creditor may enforce its security right without being required to exercise any recourse against any person liable for the payment of the Obligations or to realize on any other security.

#### 7.4 Inconsistency with the Credit Agreement

In the event of any conflict or inconsistency between the provisions of this agreement and the provisions of the Credit Agreement, the provisions of the Credit Agreement will prevail.

### 8. Governing Law

This agreement will be governed by and construed in accordance with the laws of State A. The provisions of this agreement must also be interpreted in order to give effect to the intent of the parties that the Secured Creditor's security right be valid and effective in all jurisdictions where the Encumbered Assets may be located and where the rights of the Secured Creditor may have to be enforced.

### 9. Notices

Any notice by a party to the other must be in writing and given in accordance with the notice provisions of the Credit Agreement.

<sup>9</sup> This is a personal obligation of the Grantor and may not necessarily be enforceable against the owner of premises leased to the Grantor, unless the owner consents.

**Counterparts and signatures**

This agreement may be executed in any number of counterparts and by each party in separate counterparts and any full set of these separate counterparts will constitute an original copy of this agreement. Delivery of an executed counterpart of a signature page to this agreement by electronic mail will be as effective as delivery of a manually executed counterpart of this agreement.

**SIGNED** by the parties as of 18 October 2019

[Name of the grantor]

[Name of the secured creditor]

[Signature of the grantor]

[Signature of the secured creditor]

\_\_\_\_\_

---

## Annex V

### Sample retention-of-title clause

The following provides sample clauses for use in a sales contract relating to a specific asset intended to be used by the purchaser in the operation of its business.

- \*. The Asset sold under this contract will remain the property of the Seller until the purchase price has been paid in full. Therefore, the ownership of the Asset will be transferred to the Purchaser only when such payment in full is made to the Seller.
- \*. The Purchaser authorizes the Seller to register any notice and take any other action necessary to make the Seller's retention of ownership in the Asset effective against third parties.
- \*. Until ownership of the Asset has been transferred to the Purchaser, the Purchaser will not sell, lease or otherwise dispose of the Asset or grant a security right in the Asset, in each case, without the written consent of the Seller.
- \*. The Purchaser will not attach or affix the Asset to immovable property without the prior written consent of the Seller.

## Annex VI

### Sample template for grantor's authorization for registering a notice in the Registry

The undersigned (the Grantor) authorizes [the name and address of the secured creditor] and any of its representatives to register a notice in [the name of the Registry in the enacting State] with respect to the security right in (*complete only one*):

- all of the Grantor's present and future movable assets
- all of the Grantor's present and future movable assets except the following items or types of assets:  
\_\_\_\_\_
- the following items/types of assets:  
\_\_\_\_\_.

[ \_\_\_\_\_ is the maximum amount for which any security right that is granted in the assets described above may be enforced, and the amount set out in any related security agreement and registered notice will not exceed this amount.]<sup>1</sup>

This authorization is subject to and valid until a security agreement is entered into between the parties with respect to the assets described above.

[date]

[name of the grantor]

[signature of the grantor]

<sup>1</sup> The text in square brackets is only relevant if the enacting State has adopted article 6(3)(d) of the Model Law (and therefore also articles 8(e) and 24(7) of the Model Registry Provisions).

## Annex VII

### Sample template for requesting the registration of an amendment or cancellation notice

When obliged to do so, a secured creditor will in most cases voluntarily register an amendment or cancellation notice (see table in section II.E.10). If it does not, the grantor can send a written request to the secured creditor asking it to do so. The following provides a template for the grantor to make such a request to the secured creditor.

<p>To [name of the secured creditor],</p> <p>A notice was registered on [date of registration] in the [the name of the Registry in the enacting State] with the registration number [ ] (the "Notice"). In the Notice, [the name of the secured creditor] is named as the secured creditor and I am named as the grantor.</p> <p>[Explanation of the circumstance which requires the registration of an amendment or cancellation notice]</p> <p>Therefore, I request that the Notice (complete only one):</p> <p><input type="checkbox"/> be cancelled by registering a cancellation notice</p> <p><input type="checkbox"/> be amended by registering an amendment notice that deletes the following assets from the description of encumbered assets:</p> <p>_____</p> <p><input type="checkbox"/> be amended by registering an amendment notice that reduces the maximum amount for which the security right may be enforced to the following amount: _____<sup>1</sup>.</p> <p>According to [relevant provision, for example, article 20(6) of the Model Registry Provisions], you are required to register the notice mentioned above no later than [date specified by the enacting State] days after you receive this request.</p> <p>If you fail to register the requested notice, I am entitled to seek an order for its registration unless, in the meantime, you register an order of a court maintaining the registration.</p> <p style="text-align: right;">[date]</p> <p style="text-align: right;">[name of the grantor]</p> <p style="text-align: right;">[signature of the grantor]</p>
---

<sup>1</sup> The last box and the following text is only relevant if the enacting State requires the maximum amount for which the security right may be enforced to be included in the security agreement (ML art. 6(3)(d), MRP arts. 8(e), 20(2) and 24(7)).

## Annex VIII

## Sample borrowing base certificate

Name of Borrower: [                    ]			
Name of Lender: [                    ]			
Loan Number: [                    ]			
Certificate No.: [                    ]			
Period Covered: [DD/MM/YYYY] to [DD/MM/YYYY]			
CATEGORY OF ASSETS	Receivables	Inventory	Total Eligible Collateral
<i>Description</i>			
1. Beginning Balance (from previous certificate)	.		
2. Additions to Collateral (Gross Sales /Purchases)			
3. Deductions to Collateral (Cash Received)			
4. Deductions to Collateral (Other) <sup>1</sup>			
<b>5. Total Collateral Balance</b>			
6. Less Ineligible Receivables <sup>2</sup>			
7. Less Ineligible Inventory <sup>3</sup>			
<b>8. Total Eligible Collateral</b> (Line 5 minus Lines 6 and 7)			
9. Advance Rate Percentage (per loan agreement)	%	%	
<b>10. Net Available to Borrower (Borrowing Base Value)</b> (Line 8 multiplied by Line 9)			
11. Less Reserves <sup>4</sup>			
<b>12. Total Borrowing Base Value</b> (Line 10 minus Line 11)			
<b>13. Maximum Revolving Line of Credit</b>			<b>Total Revolver Line:</b>
<b>14. Maximum Borrowing Limit</b> (Lesser of 12 and 13)			<b>Total Available:</b>
Pursuant to [description of the loan agreement, including a date], the Borrower is signing and delivering this Borrowing Base Certificate to the Lender, and represents and warrants to the Lender that the information contained in this Certificate is true and correct.			
[date]			
[name of the borrower]			
[signature of the borrower]			

<sup>1</sup> Include those resulting from discounts or credits given to customers.

<sup>2</sup> Include receivables that are ineligible or unacceptable for borrowing, for example, receivables that are

- past due beyond a specified number of days;
- deemed to be past due because a sufficiently high percentage of the receivables owed by the same debtor are past due;
- owed by foreign customers; or
- subject to set-off by the customer.

<sup>3</sup> Include inventory that is ineligible or unacceptable for borrowing, for example, inventory that

- is obsolete or slow-moving;
- is not physically located on the grantor's premises either because it is held by a third party (such as a processor or a storage warehouse) or is in-transit to the grantor's place of business and is not covered by an acceptable agreement giving the secured creditor access to, and control of, the inventory;
- consists of work-in-process that is not readily saleable (and therefore has little value); or
- is not owned by the grantor, but rather has been delivered to the grantor's premises by a third party on consignment.

<sup>4</sup> Include reserves against the Borrowing Base, such as (i) reserves for priority claims imposed by applicable law for unpaid wages or taxes or (ii) three months' rent for the Borrower's leased premises when a collateral access agreement has not been obtained from the landlord.

## Annex IX

### Template for disposing the encumbered asset

As a way of enforcing its security right, a secured creditor can dispose the encumbered asset itself (see Section II.H.4). The following provides a template to be used by a secured creditor when it intends to dispose of the encumbered asset.

<p>To [name of the grantor or any other person],</p> <p>According to [description of the security agreement], the undersigned has a security right in the [description of the encumbered asset] to secure payment arising from [description of the transaction which gave rise to the secured obligation]. At present, the payment of [an amount to satisfy the secured obligation including interest and enforcement cost (A)] is required to satisfy the secured obligation and to extinguish the security right.</p> <p>The undersigned hereby informs you its intention to dispose of the [description of the encumbered asset] to satisfy the secured obligation. The sale will take place [time, place and manner of the disposition].</p> <p>You or any other person with a right in the [description of the encumbered asset] may terminate this disposition by paying the amount mentioned above to the following:</p> <p>[name of the secured creditor and any contact details]</p> <p>[account information for making wire transfer or direct payment]</p> <p>If no payment is made before [date], the undersigned will proceed to the disposition of [description of the asset].</p> <p style="text-align: right;">[date]</p> <p style="text-align: right;">[name of the secured creditor]</p> <p style="text-align: right;">[signature of the secured creditor]</p>
--

**Annex X****Sample template for proposing the acquisition of the encumbered asset**

As a way of enforcing its security right, a secured creditor can propose to acquire the encumbered asset as full or partial satisfaction of what it is owed. The following provides a sample template to be used by a secured creditor when it proposes to acquire the asset to the grantor as full satisfaction of the secured obligation. Such a proposal should be in writing and should also be sent to other persons as required under article 80(2) of the Model Law.

<p>To [name of the grantor or any other person],</p> <p>According to [description of the security agreement], the undersigned has a security right in the [description of the encumbered asset] to secure payment arising from [description of the transaction which gave rise to the secured obligation]. At present, the payment of [an amount to satisfy the secured obligation including interest and enforcement cost (A)] is required to satisfy the secured obligation and to extinguish the security right.</p> <p>The undersigned hereby offers to acquire the [description of the encumbered asset] in full satisfaction of the secured obligation.</p> <p>You or any other person with a right in the [description of the encumbered asset] may terminate this acquisition by paying the amount mentioned above to the following:</p> <p>[name of the secured creditor and any contact details]</p> <p>[account information for making wire transfer or direct payment]</p> <p>You or any other person may raise an objection to the acquisition in writing. If no objection is received before [date], the undersigned will acquire the [description of the asset] on that date.</p> <p style="text-align: right;">[date]</p> <p style="text-align: right;">[name of the secured creditor]</p> <p style="text-align: right;">[signature of the secured creditor]</p>
--

## Annex XI

### Sample template for payment instructions

The following is a sample template which can be used by a secured creditor in enforcing its security right in a receivable. It requests the debtor of the receivable to make payment to the secured creditor (ML art. 82).

The template can also be used by a secured creditor with a security right in a negotiable instrument or a bank account to requesting the obligor under a negotiable instrument, or the deposit-taking institution to make payment to it.

The language in the payment instruction should generally follow the wording of the contract, which the respective obligation arose under.

<p>To [name of the debtor of the receivable],</p> <p>According to [description of the security agreement], the undersigned has a security right in [description of the receivable] in favour of [name of grantor] arising from [description of the transaction which gave rise to the receivable arose]. This includes all receivables which will arise in the future where the debtor of the receivable is obliged to pay [name of the grantor].</p> <p>According to [relevant provision, for example, article 82 of the Model Law], the undersigned has the right to collect payment of the receivable owed by you and to further enforce any personal or property right that secures or supports payment of the receivables.</p> <p>You are hereby instructed to make all payments which are currently due or will become due to the following:</p> <p>[name of the secured creditor and any contact details]</p> <p>[account information for making wire transfer or direct payment]</p> <p>You will be discharged from the obligations only if you make payment as instructed above.</p> <p style="text-align: right;">[date]</p> <p style="text-align: right;">[name of the secured creditor]</p> <p style="text-align: right;">[signature of the secured creditor]</p>
---

\_\_\_\_\_