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Draft Security Rights Registry Guide

Note by the Secretariat

Addendum

Contents

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IV. Rules applicable to the registration and search process

A. Introduction

1. In the interest of legal certainty, a State establishing a security rights registry will need to adopt a set of rules to regulate the registration and search process. The goal of this chapter is to identify the issues that must be addressed in these rules and provide guidelines for their treatment in line with the *Guide* (in particular, chapter IV).

2. As already noted (see A/CN.9/WG.VI/WP.48, para. 21), under the law recommended in the *Guide*, registration of a notice in the general security rights registry is the general method for making the security right effective against third parties (see recommendation 32); and priority among security rights made effective against third parties by such a registration is determined on the basis of the time of registration (see recommendation 76). This means that registration or failure to effect a registration has consequences for the third-party effectiveness and priority of a security right (see A/CN.9/WG.VI/WP.48, para. 46).

B. Grantor authorization for registration

3. Under the law recommended in the *Guide*:

(a) Registration of a notice (whether the initial, amendment or cancellation notice) with respect to a security right is ineffective unless authorized by the grantor in writing, which may be in the form of an electronic communication (see recommendations 11, 12 and 71);

(b) Authorization is not necessary at the time of registration as long as it is given subsequently (see recommendation 71) and thus registration may take place even before the creation of a security right or the conclusion of a security agreement (recommendation 67); and

(c) A written security agreement is sufficient to constitute authorization (see recommendation 71).

4. As a result, if a security agreement is concluded in writing after registration took place without prior authorization, the security agreement constitutes authorization and makes the registration effective as of the time of registration. If, however, a security agreement is not concluded in writing (and there is no other written authorization by the grantor), there is no security right and the registration is ineffective. Accordingly, if a subsequent notice was registered (with authorization by the grantor), the formerly registered security right would have priority only if authorization was obtained or if a security agreement was concluded after its registration. Otherwise, there will be no priority conflict as the formerly registered security right would be ineffective against third parties. Authorization may be necessary not only for the initial notice but also for any subsequent amendment notice. Generally, additional authorization is required for two types of amendment, those that add encumbered assets and those that add grantors.

5. In contrast, some registry systems require the grantor’s authorization to be evidenced on the registry record itself at the time of registration. This requirement

adds cost and time to the registration process since it requires reliable verification that the person giving authorization is in fact the grantor named in the notice and that the person has actually given authorization. Such a requirement could add complexity to the registration process in particular where information is entered into the registry record via electronic means of communication.

6. Such registry systems may be influenced by an inappropriate analogy with title registries. In a title registry, such a requirement makes sense insofar as the rights of the true owner may be lost if an unauthorized transfer is entered into the record and the person named as the new owner then proceeds to dispose of the asset. However, in a security rights registry system of the kind contemplated by the *Guide*, registration does not create a security right or evidence that it actually exists; it merely provides notice of the possible existence of a security right in the described assets (see recommendations 32 and 33, see also A/CN.9/WG.VI/WP.48, paras. 44 and 59). This is prejudicial to the person identified in the registration as the grantor only insofar as it may impede that person's ability to deal freely with the assets described in the registration until the registration is cancelled or amended (in some States, unauthorized registrations are added by credit reporting agencies to credit reports of individuals and may thus affect the creditworthiness of a person).

7. Under the law recommended in the *Guide*, the risk of such unauthorized registration can be efficiently dealt with by enabling the grantor to quickly and inexpensively seek cancellation (where there is no authorization at all) or amendment (where there is partial authorization) of the unauthorized registration from the secured creditor and, if the secured creditor does not correct the record within a short period of time specified in the law after receipt of a written request of the grantor, through a summary administrative or judicial procedure (see recommendations 72, subpara. (b), and A/CN.9/WG.VI/WP.48/Add.2, chap. IV, sect. H). To facilitate the exercise of this right of the person identified in the notice as the grantor, the registrant is required to send a copy of the initial registration or any subsequent amendment notice to the person identified in the notice as the grantor (see recommendation 55, subpara. (c)); in an electronic system, the registry may be designed so that a copy of the registration is automatically sent (see A/CN.9/WG.VI/WP.48/Add.2, paras. 34-38).

8. Further protection against unauthorized registrations may be achieved by requiring registrants to provide some form of identification as a pre-condition to submitting a notice for registration. The main reason for this approach is to ensure legitimate use of the registry (which may be a concern in some States). The disadvantage is that it is likely to increase the time and cost of registration. This requirement though need not pose an excessive administrative burden if the identification procedure is built into the payment process. In addition, since most registrants are likely to be repeat customers, a permanent secure access code can be assigned when the account with the registry is opened, eliminating the need to repeat the identification procedures for subsequent registrations. Moreover, the efficiency of the registration process is not undermined if the registry requires and maintains but does not verify the identity of the registrant (see recommendations 54, subpara. (d), and 55, subpara. (b); see also the *Guide*, chap. IV, para. 48).

9. Additional sanctions aimed at protecting grantors against unauthorized registrations depend on the determination made by each State as to the extent of the risk of unauthorized and fraudulent registrations relative to the cost of administering

prescriptions of this nature (see the *Guide*, chap. IV, para. 20). One possible way is to subject a person that effects an unauthorized registration to liability for any damages caused to the person identified in the registration as the grantor and to criminal or monetary penalties if it is established that the registrant acted in bad faith or with the intent to harm the interests of the grantor.

[*Note to the Working Group: The relevant article in the draft model regulations is article 12.*]

C. Advance registration

10. Advance registration refers to registration of a notice before the creation of the security right or the conclusion of a security agreement. In the notice registration system contemplated by the *Guide* (see A/CN.9/WG.VI/WP.48, paras. 61-67), the registrant is not required to register the actual security documentation. All that is registered is the basic information contained in a notice that is sufficient to alert a third-party searcher that a security right may exist in the described assets (see recommendation 57). This approach enables advance registration and the *Guide* recommends that such advance registration be expressly permitted by law (see recommendation 67). Thus, advance registration may not be challenged as being ineffective simply because it took place before the creation of the security right or the conclusion of the security agreement. However, as mentioned in section B above, advance registration would require authorization from the grantor at some point of time after the registration in order to be effective.

11. Advance registration by itself does not, however, ensure that the secured creditor will necessarily have priority over other classes of competing claimants. As explained in chapter II (see A/CN.9/WG.VI/WP.48, para. 44), registration does not create and is not necessary for the creation of a security right (see also recommendation 33). Consequently, until the security agreement is actually entered into and the other requirements for the creation of a security right are satisfied, the secured creditor may be defeated by a competing claimant, such as a buyer that acquires rights in the encumbered assets in the intervening period between advance registration and the creation of the security right.

12. If the negotiations are aborted after the registration is effected and no security agreement is ever entered into between the parties, the creditworthiness of the person named as grantor in the registration may be adversely affected unless the registration is cancelled. This risk, like the risk of unauthorized registrations generally, can be controlled by: (a) requiring the secured creditor (or, in the case of an electronic registry, the registry system) to notify the person identified in the notice as the grantor in a timely manner about the registration of the notice (see recommendation 55, subpara. (c)); (b) making it an obligation for the secured creditor to cancel a notice in certain cases (see recommendation 72, subpara. (a)); and (c) providing a summary judicial or administrative procedure to enable the person identified in the notice as the grantor to compel the cancellation of the notice. If a security agreement is entered into after the registration but its terms do not correspond to the content of the registered notice, the person identified in the notice as the grantor may seek the amendment of the notice (see

recommendations 54, subpara. (d), and 72, subparas. (b) and (c), as well as A/CN.9/WG.VI/WP.48/Add.2, paras. 15-21).

[*Note to the Working Group: The relevant article in the draft model regulations is article 12.*]

D. Sufficiency of a single notice

13. Under the law recommended in the *Guide*, the registration of a single notice is sufficient to achieve third-party effectiveness of one or more than one security right, whether they exist at the time of registration or are created later and whether they arise from one or more than one security agreements between the same parties (see recommendation 68). The registration continues to be effective, however, only to the extent that the description of the assets in the notice corresponds to their description in any new or amended security agreement. For example, if a new security agreement covers new assets or categories of assets that were not described in the initial registration, a new registration or an amendment would be needed. The priority of a security right with in such assets not previously described in a registered notice would date only from the registration of a new notice or amendment.

14. In a notice registration system of the kind contemplated by the *Guide* where the security agreement is not required content of a notice (see recommendation 57), there is no reason why a single notice should not be sufficient to give third-party effectiveness to, present or future, security rights arising under multiple security agreements between the same parties. Requiring a one-to-one relationship between each notice and each security agreement would generate unnecessary costs and undermine the ability of the secured creditor to flexibly respond to the grantor's evolving financing needs without having to fear a loss of the priority position it holds under the initial registration.

[*Note to the Working Group: The relevant article in the draft model regulations is article 13.*]

E. Information required in a notice

15. Under the law recommended in the *Guide*, only the following information needs to be provided in a notice: (a) the identifier and address of the grantor; (b) the identifier and address of the secured creditor or its representative; (c) a description of the asset; (d) the duration of the registration, if the law allows parties to select it; and (e) the maximum monetary amount for which the secured creditor may enforce the security right, if the law allows it (see recommendation 57). The following paragraphs discuss each of the elements of the required content of a notice.

[*Note to the Working Group: The relevant article in the draft model regulations is article 17.*]

1. Grantor information

(a) General

16. As already explained (see A/CN.9/WP.48, paras. 65-67), information contained in notices is indexed by reference to the grantor's identifier and not according to the encumbered asset or other information required in a notice. In order to ensure that a search of the registry discloses all security rights that may have been granted by a person, the rules applicable to registration should make it clear that the grantor's identifier is a required component of a notice.

17. In line with law recommended in the *Guide* (see recommendation 58), any rules applicable to registration should provide explicit guidance on what constitutes the correct identifier of the grantor. The purpose of these rules should be to ensure that a secured creditor can be confident that its registration will be legally effective and searchers can confidently rely on a search result.

18. It is not uncommon for a person to create a security right in its assets to secure an obligation owed by a third-party debtor. Since the function of registration is to disclose the possible existence of a security right in the assets described in the notice, the rules applicable to the registration process should make it clear that the information required is the identifier and address of the grantor that owns, or has rights in, the encumbered assets, and not the debtor of the secured obligation (or a mere guarantor of the obligation owed by the debtor).

(b) Natural persons versus legal persons

19. The general security rights registry contemplated by the *Guide* envisages that information contained in the notices will be stored in a centralized and consolidated registry record (see A/CN.9/WG.VI/WP.46/Add.2, paras. 48 and 49). Thus, while the *Guide* provides separate rules with respect to the identifier of the grantor depending on whether the grantor is a natural or a legal person (see recommendations 59-60), regardless of whether the grantor is a natural or a legal person, all notices will be stored in a single registry (see the *Guide*, chap. IV, paras. 21-24).

20. This also has implications for the registration and search process. In registry systems that distinguish grantors that are natural persons from grantors that are legal persons (and thus permit separate searches), the registrant would have to indicate whether the grantor is a natural person or legal person in the category of the grantor during the registration process. In such cases, it is also critical for the registry searchers understand the registry system, since a search of the registry record against the identifier of a natural person will not disclose a security right registered against a grantor that is a legal person with the same identifier.

(c) Grantor identifier for natural persons

21. The *Guide* recommends that, if the grantor is a natural person, the identifier of the grantor for the purposes of an effective registration should be the name of the grantor as it appears in a specified official document (see recommendation 59). It further recommends that, where necessary (for example, where the grantor's name is common), additional information such as the birth date or identity card number, should be required to uniquely identify the grantor. In line with the law recommended in the *Guide*, the rules applicable to the registration process should

make it clear that it is the responsibility of the registrant (and not the registry) to enter the correct identifier of the grantor in accordance with these rules.

22. A rule implementing this approach may determine, as the following table illustrates, examples in order to accommodate the particular circumstances of different categories of grantors (the responsibility for entering the correct identifier of the grantor in the appropriate order and in the appropriate field in accordance with these rules lies with the registrant).

Grantor status	**Grantor identifier**
Born in enacting State	[(1)] Name on birth certificate or equivalent official document [(2) Personal identification number]
Born in enacting State but birth not registered in enacting State	(1) Name on current passport (2) If no passport, name on equivalent official document (e.g. driver's licence) (3) If no passport or equivalent official document, name on current foreign passport from jurisdiction of habitual residence
Born in enacting State but birth name subsequently changed pursuant to change of name	Name on a birth certificate or equivalent official document (such as a marriage certificate)
Not born in enacting State but naturalized citizen of enacting State	Name on citizenship certificate or equivalent official document
Not born in enacting State and not a citizen of enacting State	(1) Name on current passport issued by the State of which the grantor is a citizen (2) If no current foreign passport, name on birth certificate or equivalent official document issued at grantor's birth place
None of the above	Name on any two official documents issued by the enacting State, if those names are the same (for example, a current motor vehicle operator's licence and a current government medical insurance identification card)

23. It is equally important to have clear rules specifying what components, as well as in what order those components, of the name in the official document are required (for example, family name, followed by the first given name, followed by the second given name). In addition, the name parts should be treated as individual parts and thus each name part should have its own field and not concatenated into one single element. It should, however, be noted that not all official documents specify the components of the name. Guidance should also be provided for exceptional situations (for example, where the grantor's name consists of a single word).

24. In many States, many persons may have the same name, with the result being that a search under that name may disclose multiple grantors with the same name.

As already mentioned (see para. 21 above), the *Guide* recommends that, where necessary, additional information, such as the birth date or an identity card number, should be required to uniquely identify the grantor (if the registry system is so designed, additional information may be included in a notice in other cases at the discretion of the registrant). Whether an identification number (alphanumeric or other code) should be indicated in a notice depends on three principal considerations. First, whether the system under which the identification numbers are issued is sufficiently universal and reliable to ensure that each natural person is assigned a unique number (that is also permanent; otherwise, rules would be required to address any changes). Second, whether the public policy of the enacting State permits the public disclosure of the identification number assigned to its citizens and/or residents. Third, whether there is a documentary or other source by which third-party searchers can objectively verify whether a particular identification number relates to the particular grantor. If searchers must instead rely solely on the grantor's representations as to the grantor's identification number, this may not be reliable. If the above-mentioned conditions are met, the use of identification numbers would be an ideal way to uniquely identify grantors. However, as mentioned above, the approach recommended in the *Guide* is that additional information, such as an identification number, may be used only where necessary to uniquely identify a grantor (see recommendation 59).

25. Even if an identification number is used to uniquely identify a grantor, it will still be necessary to include supplementary rules to accommodate cases where the grantor is not a citizen or resident of the enacting State, or, for any other reason, has not been issued an identification number (unless a State accepts the number of the foreign passport as sufficient to identify foreign nationals).

[*Note to the Working Group: The relevant article in the draft model regulations is article 18.*]

(d) Grantor identifier for legal persons

26. For grantors that are legal persons, the *Guide* recommends that the correct identifier for the purposes of effective registration is the name that appears in the document constituting the legal person (see recommendation 60). Virtually all States maintain a public commercial or corporate register for recording information about legal persons constituted under the law of that State including their names. Accordingly, the required identifier for registration and search purposes should be the name as it appears on the public record constituting the legal person. The rules governing registration should provide whether an abbreviation which is indicative of the type of body or entity should be considered part of the identifier. It should also be noted that, in many States, upon registration in that record, a unique and reliable registration number is assigned to each legal person, which may additionally be used to identify the grantor.

[*Note to the Working Group: The Working Group may wish to consider the following addition to the commentary and the draft model regulations: "If the document constituting a legal person includes a number of variations of the name (such as "The ABC inc." or "ABC Inc." or "ABC"), the rules should indicate that the grantor's identifier is the grantor's name that is designated as the "name of the grantor" in the document".*]

27. Supplementary rules would need to be developed to accommodate cases where the legal person was constituted in a foreign State, in particular, whether the name or registration number that appears on the public record of a foreign State may be used as the identifier of the legal person in the enacting State.

[*Note to the Working Group: The relevant article in the draft model regulations is article 19.*]

(e) Other types of grantor

28. The rules governing registration will also need to set out additional guidelines on the required grantor identifier where the grantor does not precisely fit into either the natural person or the legal person categories. The following table illustrates the types of situations that will need to be addressed, together with examples of possible identifiers.

Grantor status	**Grantor identifier**
Estate of a deceased natural person or an administrator acting on behalf of the estate	Identifier of the deceased person, in accordance with the rules applicable for grantors who are natural persons, with the specification in a separate field that the grantor is an estate or an administrator acting on behalf of the estate
Estate of an insolvent natural person acting through an insolvency representative	Identifier of the insolvent natural person, in accordance with the rules applicable for grantors who are natural persons, with the specification in a separate field that the grantor is insolvent
Estate of an insolvent legal person acting through an insolvency representative	Identifier of the insolvent legal person in accordance with the rules applicable for grantors who are legal persons, with the specification in a separate field that the grantor is insolvent
Trade union that is not a legal person	Name of the trade union as set out in the document constituting the trade union[, and, where required, additional information, such as the name(s) of each person representing the trade union in the transaction in accordance with the rules applicable for grantors who are natural persons]
Trust or a trustee acting on behalf of the trust and the document constituting the trust designates the name of the trust	Name of the trust as set out in the document constituting the trust, with the specification in a separate field that the grantor is a “trust” or a “trustee”
Trust or a trustee acting on behalf of the trust and the document constituting the trust does not designate the name of the trust	Name of the trustee, in accordance with the rules applicable for grantors who are natural persons or legal persons as the case may be, with the specification in a separate field that the grantor is a “trust” or a “trustee”

Participant in a legal person that is a syndicate or joint venture	Name of the syndicate or joint venture as set out in the document constituting it[, and, where required, additional information, such as the name of each participant in accordance with the rules applicable for grantors who are natural persons or legal persons as the case may be]
Participant in a legal person other than a syndicate or joint venture	Name of the legal person as set out in the document constituting it[, and, where required, additional information, such as the name of each natural person representing the legal person in the transaction to which the registration relates, determined in accordance with the rules applicable for grantors who are natural persons]
Any other entity that is not a natural or legal person already referred to above	Name of the entity as stated in the documents creating the entity[, and, where necessary, additional information, such as the name of each natural person representing the organization in the transaction to which the registration relates, in accordance with the rules applicable for grantors who are natural persons]

29. In the case of sole proprietorships, even though the business may be operated under a different business name and style than that of the proprietor, registration rules typically provide that the grantor's identifier is the name of the proprietor in accordance with the rules applicable for grantors who are natural persons. The name of the sole proprietorship is unreliable and may be changed at will by the proprietor. However, the name of the sole proprietorship may be entered as an additional grantor in the notice.

30. As noted above, systems for electronic registration of notices should be designed to allow registrants to select from a category field with the appropriate designation (for example, estate, insolvent, trust, trustee and etc.) instead of entering the designation in the name field of the grantor. Alternatively, the notice may include a field or item in which the registrant must enter the appropriate designation.

[*Note to the Working Group: The relevant article in the draft model regulations is article 20. The Working Group may wish to consider whether the rules in article 20 should be presented as examples or whether it is sufficient to indicate that in the commentary (see paras. 22 and 28 above).*]

(f) Address of the grantor

31. While, under the law recommended in the *Guide*, the grantor's address is not part of the grantor's identifier (recommendation 59), where necessary (for example, where the grantor's name is common; see recommendation 59), it should also be required in the notice to uniquely identify the grantor. The address of the grantor is part of the required content of the notice (see recommendation 57, subpara. (a)) also: (a) to enable the registrant (or, in the case of an electronic registry, the registry system) to forward copies of registered notices to the grantor (see recommendation 55, subparas. (c) and (d)); and (b) to enable searchers that are not already dealing with the grantor to contact the grantor for further information.

32. Some States do not require the grantor's address because personal security concerns necessitate that an individual's address details not be disclosed in a publicly accessible record (although using a post office box or similar non-residential mailing address may alleviate this concern). In those States, interested parties are required to contact the secured creditor (whose address must be mentioned in the notice) and obtain further information about the grantor, if they are not already in contact with the grantor.

33. It should be noted that, the grantor's address plays less of a role in systems in which the required grantor identifier is unique (for example, a government-issued identification number) as compared to systems in which the identifier is the grantor's name and in which a search may disclose multiple security rights granted by different grantors that share the same name (see paras. 24-25 above).

[*Note to the Working Group: The Working Group may wish to consider whether a discussion of the various types of addresses, set out in the definition of the term "address" (see A/CN.9/WG.VI/WP.48/Add.3) should be included in the commentary, and, if so, provide guidance in that respect to the Secretariat.*]

(g) Grantor information and impact of error

34. The law recommended in the *Guide* provides that registration of a notice is effective only if it provides the grantor's correct identifier or, in the case of an incorrect statement, if the notice would be retrieved by a search of the registry record under the correct identifier (see recommendation 58). Therefore, an error in the grantor's identifier submitted by the registrant could render a registration ineffective, with the result being that third-party effectiveness of the security right would not be achieved. The relevant rule makes it clear that the test should not be based on whether the error appears to be minor or trivial in the abstract, but whether it would cause the information in the registry record not to be retrieved by a search of the registry record under the grantor's correct identifier. This is because the grantor's identifier is the search criterion for retrieving information submitted in a notice and entered in the registry record. The test is an objective one, since: (a) even if a searcher knew that a security existed and had been registered, the search would still be ineffective if the relevant notice could not be retrieved by a search of the registry record under the correct grantor identifier; and (b) the registration is ineffective regardless of whether a person challenging the effectiveness of the registration suffered any actual prejudice as a result of the error.

35. The law recommended in the *Guide* does not prescribe the impact of an error in additional grantor information that does not constitute the grantor's identifier, for example, an error in the address of the grantor or in the grantor's birth date. Guidance on this issue should be included in the rules applicable to registration and searching. By analogy to the general test recommended in the *Guide* for errors in the entry of secured creditor information, the rules should specify that an error in the additional grantor information that does not constitute an identifier does not render a registered notice ineffective unless it would seriously mislead a reasonable searcher (see recommendation 64). For example, if the search result discloses numerous grantors all bearing the same name and yet the error in the additional grantor information is so acute as to make the reasonable searcher firmly believe that the relevant grantor was not included in the list, a notice indicating that grantor may be found to be ineffective.

[*Note to the Working Group: The Working Group may wish to consider whether in situations in which the additional grantor information is required to uniquely identify the grantor and is thus part of the required grantor identifier (for example, where the grantor's name is very common)), the rules applicable to an error in grantor identifier (that is, recommendation 58) should apply to an error in additional grantor information.*]

36. In registry systems that store information provided in notices in an electronic database, the search logic may be programmed so as to return close matches to the grantor identifier entered by the searcher. In such a system, a registration may be considered effective even though the registrant had made a minor error in entering the correct grantor identifier. This is because a searcher entering the correct grantor identifier would still be able to retrieve the registration (with the error) and consider it likely that the grantor whose identifier appears on the search result as an inexact but close match is nonetheless the relevant grantor. Whether this is the case depends on such factors as whether: (a) a reasonable searcher would be able to readily identify the grantor by referring to additional information, such as address, birth date or identification number; (b) the list of inexact matches is so lengthy as to prevent the searcher from efficiently determining whether the grantor which it is interested in is included in the list; and (c) the rules for determining "close" matches are objective and transparent so that a searcher will be able to rely on the search result.

37. In some of these registry systems, the indexing and search logic for grantor identifiers is programmed so as to ignore all punctuation, special characters and case differences and to ignore selected words or abbreviations that do not make an identifier unique (such as articles of speech and indicia of the type of enterprise such as "company", "partnership" "LLC" and "SA"). Where this is the case, an error in the entry of this type of information will not render the registration ineffective since the registration will still be retrieved despite the error.

[*Note to the Working Group: The relevant article in the draft model regulations is article 25.*]

2. Secured creditor information and impact of error

38. The law recommended in the *Guide* requires that the identifier of the secured creditor or the secured creditor's representative, along with its address, be included in the notice submitted to the registry (see recommendation 57, subpara. (a)).

39. The identifier rules that apply to the grantor should apply also to the secured creditor or its representative. However, since the identifier of the secured creditor or its representative is not a search criterion, strict accuracy is not as essential to the effectiveness of the registration. Thus, an error in the identifier of the secured creditor should be treated differently from an error in the identifier of the grantor.

[*Note to the Working Group: The Working Group may wish to consider whether in a registry system where grantors are identified by personal identification numbers (alphanumeric or other code), the secured creditor should still be identified by its name.*]

40. Consequently, under the approach recommended in the *Guide*, an error by the registrant in the identifier or address of the secured creditor or its representative

renders the registration ineffective only if it would seriously mislead a reasonable searcher (see recommendation 64). For example, if the secured creditor is identified in the notice as bank AAA, and the search of the registry returns a result that does not include bank AAA, the registered notice may not be ineffective (bank AAA may have changed its name, merged with another bank or sold). Still, substantial accuracy is always important, since searchers rely on the identifier and address information of the secured creditor or its representative in the registry record for the purposes of sending notices under the secured transactions law (such as a notice of an extrajudicial disposition of an encumbered asset; see recommendations 149-151). Moreover, the grantor may need such information to submit a written request to the secured creditor for the cancellation or the amendment of a certain notice (recommendation 72, subpara. (a)).

[*Note to the Working Group: The relevant article in the draft model regulations is article 21.*]

3. Description of encumbered assets

(a) General

41. Under the law recommended in the *Guide*, a description of the assets to which the registration relates is a required component of an effective notice (see recommendation 57, subpara. (b)). In this way, the notice provides objective information to third parties dealing with the grantor's assets (such as prospective secured creditors, buyers, judgement creditors and the insolvency representative of the grantor).

42. In addition, under the law recommended in the *Guide*, a description of the encumbered assets is generally considered sufficient, for the purposes of both an effective security agreement and effective registration, as long as it reasonably allows identification of the encumbered assets (see recommendations 14, subpara. (d), and 63). For example, if the encumbered assets are specific artwork at a gallery, it would be sufficient to indicate the title of the painting, the name of the painter and the year the painting was created. On the other hand, if the encumbered assets are generic categories of asset, it may be sufficient to described them as "all oil paintings" or "all sculptures". Thus, the rules on registration should explicitly state that the description of encumbered assets in a notice may be specific or generic as long as it reasonably allows their identification (for example, "all of the grantor's movable assets" or "all of the grantor's inventory and receivables"). The rules might also state that a description that refers to all assets within a generic category or to all assets of a grantor is assumed to cover future assets within the specified category to which the grantor acquires rights during the duration of effectiveness of the notice.

[*Note to the Working Group: The relevant article in the draft model regulations is article 22.*]

(b) Description requirements for "serial number" assets

43. There is a limited number of movable asset for which there is a significant resale market (for example, motor vehicles, trailers, mobile homes, aircraft frames and engines, railway rolling stock, boats and boat engines). These types of asset are typically referred to as "serial number assets" (see definition of the term in article 1 of the draft model regulations contained in document A/CN.9/WG.VI/WP.48/Add.3).

Under the law recommended in the *Guide*, the registrant may include serial number and type of asset in the description of the encumbered assets in the notice as long as it reasonably allows their identification (see recommendations 14, subpara. (d), 57, subpara. (b), and 63). If such a description were necessary though, the ability of a secured creditor to make a security right effective against third parties in the grantor's future serial number assets through a single registration (in which the relevant assets would be described simply in generic terms) would be limited. The secured creditor would have to effect a new registration or amend the description of encumbered assets in its existing registration to record the serial number of each new asset as it is acquired by the grantor.

44. For this reason, a serial number description is generally not required where the serial number assets are held by the grantor as inventory. A generic description of encumbered assets simply as inventory is sufficient to enable searchers to reasonably identify the encumbered assets. In addition, the difficulty a secured creditor of a transferee of an encumbered asset may have in finding out about security rights created by the transferor (the so called "A-B-C-D problem") does not arise in the case of inventory, since buyers that acquire inventory from the original grantor in the ordinary course of the grantor's business take the inventory free of the security right in any event (see recommendation 81, subpara. (a)).

45. Where serial number and type of asset are a required component of a notice, the consequences of failure to use them (in particular, the effectiveness of the security right against third parties when the serial number or type of asset is not included in the notice or when there is an error) would need to be addressed. In addition, the registry would need to be designed so that serial number and type of asset could be entered in the notices (and then used for indexing).

46. In some States, a generic description in a notice would still be sufficient to make a security right effective against third parties. Serial number registration would generally be required only to preserve the secured creditor's right to follow the asset into the hands of a buyer or lessee from the original grantor. In other words, there would be no need to include the serial number for the purposes of achieving third-party effectiveness against other classes of competing claimants, including the grantor's secured and unsecured creditors and insolvency representative. In some States, in addition to a generic description, serial number registration is required for a secured creditor to retain its priority status based on the time of registration against a subsequent secured creditor that takes security in a serial number asset within the generic class covered by the generic description through a serial number registration. However, even in these States, a generic description remains sufficient to achieve third-party effectiveness against the grantor's unsecured creditors and insolvency representative and to preserve priority against a subsequent secured creditor that has not included a serial number description in its notice.

[*Note to the Working Group: The relevant articles in the draft model regulations are article 23 and 25, paragraph 2. The Working Group may wish to retain article 23 outside square brackets as there is nothing inconsistent with the* Guide *in requiring description of encumbered assets by serial number and type, if this is necessary to reasonably allow their identification (see recommendation 63). The Working Group may wish to consider though that article 25, paragraph 2, may be retained only if serial number is retained as an indexing criterion. If serial*

number is simply a part of the possible description of an encumbered asset, article 25, paragraph 2, may be deleted as paragraphs 3 and 4 would be sufficient to deal with an error in the serial number and type of asset as part of the description of the encumbered assets.]

(c) Description of proceeds

47. In the event that the encumbered assets are disposed of by the grantor, the law recommended in the *Guide* allows the secured creditor to claim an automatic security right in whatever identifiable asset is received in respect of the encumbered assets, unless otherwise agreed by the parties to the security agreement (see recommendation 19 and the term "proceeds" in the introduction to the *Guide*, sect. B). In this case, the question arises as to whether the third-party effectiveness of the security right in the original encumbered assets automatically extends to the security right in the proceeds or whether the secured creditor needs to take additional steps to ensure that its security right in the proceeds is effective against third parties.

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

49. However, where the proceeds are not cash proceeds and are not otherwise encompassed by the description in the existing notice, under the law recommended in the *Guide*, the secured creditor must amend its registration to add a description of the proceeds within a short period of time after the proceeds arise in order to preserve the third-party effectiveness and priority of its security right in the proceeds from the date of the initial registration (see recommendation 40). An amendment is necessary because a third party otherwise would not be able to identify which categories of asset in the grantor's possession might constitute the relevant proceeds. Accordingly, the registry should be designed in such a way that allows the secured creditor to register an amendment notice to cover the type of asset represented by the proceeds.

(d) Description of encumbered attachments to immovable property

50. Like any other type of asset, a tangible asset that is or will be an attachment to immovable property would need to be described in a manner that reasonably allows its identification (see recommendations 14, subpara. (d), 57, subpara. (b), and 63)). While a generic description of the asset will not affect the indexing of the notice in the general security rights registry (which functions with grantor indexing), it may affect indexing in the immovable property registry (which operates with asset indexing. Thus, if the notice is to be registered in the immovable property registry, the description of the asset must be sufficient to allow the indexing of the notice in the immovable property registry. In addition, if the grantor of the security right in the asset is not the owner of the immovable property, the notice must also identify the owner of the asset if such identification is necessary for the indexing of the notice in the immovable property registry.

[*Note to the Working Group: The relevant article in the draft model regulations is article 24.*]

(e) Asset description and impact of error

(i) General

51. Under the law recommended in the *Guide*, a registrant's failure to include an asset or certain type of asset in a notice means that the third-party effectiveness of the security right in any omitted asset or type of asset may not be achieved. However, as notices in a general security rights registry are generally indexed and searched by reference to the grantor's identifier, the law recommended in the *Guide* provides that a minor error in the description of the encumbered asset does not render the registered notice ineffective unless it would seriously mislead a reasonable searcher (see recommendation 64). In addition, under the law recommended in the *Guide*, a registrant's failure to meet the "seriously misleading" test means that the registration is ineffective only to the extent of those assets whereas the security right continues to be effective against third parties with respect to other assets that were sufficiently described (see recommendation 65).

52. In addition, to the extent that it reasonably allows the identification of encumbered assets, under the law recommended in the *Guide*, an all-encompassing or over-inclusive description is permitted (see recommendations 14, subpara. (d) and 63). Similar to advance registration (see paras. 10-12), this approach facilitates the ability of the parties to enter into new security agreements encumbering additional, future or revolving categories of asset as the grantor's financing needs evolve without the need for a new registration since the secured creditor can rely on the existing registration for both third-party effectiveness and priority purposes. In such a case, a question may arise as to the appropriate description of the encumbered assets when the notice refers to a generic category of asset even though the security agreement concluded or contemplated by the parties covers only certain items within that category. For example, the notice may describe the encumbered assets as "all tangible assets" whereas the relevant security agreement may cover only specified items of equipment. In any case, the over-inclusive description in the notice has to be authorized by the grantor (see recommendation 71). Otherwise, the grantor would generally be entitled to request the secured creditor or, if the secured creditor failed to act on the grantor's request in a timely fashion, an administrative or judicial authority through a summary administrative or judicial procedure to cancel or amend the notice so as to accurately reflect the actual range of encumbered assets covered by the security agreement existing between the parties (see recommendations 72 and A/CN.9/WG.VI/WP.48/Add.2, paras. 17-21).

(ii) Description and error in the description of serial number assets

53. As already mentioned, serial number assets may need to be described in a notice by reference to the serial number and the type of asset, if this is necessary to allow their reasonable identification (see recommendations 14, subpara. (d), 57, subpara. (d), and 63). If that is the case, an error in the serial number and type of asset should be treated in the same way as any other error in the description of the asset. This generally means that that a minor error in the serial number does not render the registered notice ineffective unless it would seriously mislead a reasonable searcher (see recommendation 64). If the serial number is treated as an

indexing and search criterion, an analogy could be made to the recommendation of the *Guide* applicable to incorrect or insufficient grantor identifier in the notice. Accordingly, a notice with the incorrect serial number would only be effective if it could be retrieved by a search of the registry record under the correct serial number (see recommendation 58 and paras. 38-40 above).

54. If both the grantor identifier and the serial number of the encumbered asset were to be treated as indexing and search criteria, both would need to be entered correctly in the notice for the registration of that notice to be effective (unless serial numbers were treated only as additional information necessary to describe the encumbered assets in certain cases only; see recommendation 59). As a result, should there be an error in either the grantor identifier or the serial number resulting in the notice not being retrievable by a search using the correct grantor identifier or the correct serial number, the registration of that notice would be ineffective or result in lower priority for the relevant security right as against certain competing claimants (e.g. transferees or lessee of the encumbered assets from the original grantor).

[*Note to the Working Group: The relevant article in the draft model regulations is article 25, paragraph 2.*]

4. Duration and extension of registration

(a) General

55. The *Guide* provides that an enacting State may select one of two approaches to the duration of a registration (see recommendation 69). Under the first approach, the law would specify that all registrations are subject to a standard statutory duration. In such a case, the secured creditor must ensure that the registration is renewed before its expiry. Such an approach may provide certainty as to the duration of registration, but limits the freedom of the parties to agree upon a longer duration of the registration beyond the statutory duration. Under the second approach, the law would permit the registrant to self-select the desired duration of the registration. In such a case, the indication of the duration in the notice would be a required component of the notice and without it a notice would be rejected. In legal systems that adopt the second approach, it may be desirable to base registration fees on a sliding tariff related to the duration selected by the registrant in order to discourage the selection of excessive terms that do not correspond to the duration of the underlying security agreements.

56. Although not all of them are contemplated in the *Guide* (see the *Guide*, chap. IV, paras. 87-88), there are other options as well. One option would be to not set a limited duration for the registration of a notice so that the registration would continue to be effective until it is cancelled. Another option would be a self-selection approach, yet with a fallback rule to the statutory duration, in cases where the duration had not been self-selected by the registrant. A third option, also based on the self-selection approach, would allow the selection of the duration by the registrant yet only up to a maximum temporal limit, so as to discourage the selection of excessive terms (for the last option, see the *Guide*, chap. IV, para. 88).

57. In legal systems that adopt the self-selection approach, it would also be desirable to design the registry in a way that permits the secured creditor to easily select and indicate in the notice the desired duration without the risk of inadvertent

error, for example, by limiting the choice to whole years from the date of registration.

58. Regardless of the approach a State may take to the issue of the duration of registration, under the law recommended in the *Guide*, third-party effectiveness of a security right continues past the lapse of the duration of the registration, if it was made effective against third parties prior to the lapse by some other method (see recommendation 46). This would the case, for example, if a secured creditor registered an amendment notice extending the duration of the registration or took possession of the encumbered assets before the lapse of the duration of registration. However, in the case where there was a lapse of the duration, whereby the security right would no longer be effective against third parties, the third-party effectiveness of that security right could then only be re-established, taking effect from the time of re-establishment (see recommendations 47 and 96). A re-establishment would require the registration of a new initial notice with its own date and time of registration.

(b) Duration of registration and impact of error

59. States must also address the impact on the effectiveness of registration of an incorrect statement in the notice by the registrant as to the duration of the registration. The *Guide* recommends that the error should not render the registration ineffective (see recommendation 66). However, this recommendation is subject to the important caveat that protection should be given to third parties that relied on such a statement (for the protection of the grantor against unauthorized registration, including an unauthorized statement of the duration of registration in the notice, see paras. 3-9 above).

60. Accordingly, where the registrant enters a longer duration than intended, the protection of third parties is not as relevant as they would not be prejudiced by relying on the incorrect statement. The registered notice will still alert them to the possibility that a security right may exist and that they can take steps to protect themselves against that risk. As there would be nothing on the registry record to indicate that the secured creditor intended to enter a shorter term, third-party searchers would not in any way be misled by the secured creditor's error in entering a longer term. Consequently, the error in the duration in the registered notice should not render the registration ineffective. However, in cases where the security right referred to in the notice has, in fact, been extinguished (for example, by payment of the secured obligation and termination of any credit commitment), the grantor would be able to request the secured creditor to amend or cancel the notice to reflect the correct duration. If the secured creditor failed to do so within a number of days specified in the law after receipt of the grantor's written request, the grantor could seek the amendment or cancellation of the notice through a summary judicial or administrative procedure (see recommendation 72, subparas. (a) and (b)).

61. However, where the statutory duration or the duration that the registrant entered is shorter than the actually intended duration, the registration will lapse at the end of the specified duration and the security right will no longer be effective against third parties, unless it was made effective prior to the lapse by some other method (see recommendation 46). As mentioned, while the secured creditor can re-establish third-party effectiveness, it will take effect against third parties only from the time of re-establishment (see recommendations 47 and 96).

[*Note to the Working Group: The relevant article in the draft model regulations is article 11.*]

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

(a) General

62. The *Guide* anticipates that, to facilitate subordinate lending, some States may require an indication in the notice of the maximum monetary amount for which the security right may be enforced (see recommendation 57, subpara. (d); for a corresponding indication of that amount in the security agreement, see recommendation 14, subpara. (d)). In those States, the maximum amount must be entered in a specific field of the notice. The amount may be entered either in numbers, letters or both. Some States also allow the registrant to indicate or select from a menu the relevant currency in which the loan has been made.

63. At the same time, the *Guide* recognizes that an equally valid approach is to avoid stating in the notice such a maximum amount so as to facilitate the extension of credit by the initial secured creditor (see the *Guide*, chap. IV, paras. 92-97). Thus, the *Guide* acknowledges that both approaches have merit and recommends that States adopt the policy that is most consistent with efficient financing practices in each State and, in particular, with the credit market practices that underlie each approach (see recommendation 57, subpara. (d)).

64. In secured transactions regimes that require a statement of the maximum amount for which the security right may be enforced to be included in the notice, the legal consequences of a difference in the maximum amount specified in the notice and the amount actually owed need to be addressed. If the maximum amount specified in the notice is higher than the amount actually owed at the time of enforcement, the secured creditor is entitled to enforce its security right only up to the amount actually owed. In the contrary case where the maximum amount specified in the notice is lower than the amount actually owed, the secured creditor can enforce its security right only up to the maximum amount specified in the notice (and has the remedies of an unsecured creditor for the outstanding balance). However, if there is no other competing claimant, the secured creditor would be able to enforce its security right up to the amount actually owed. In either case, if the amount actually owed or the maximum amount specified in the notice is higher than the amount specified in the security agreement, the secured creditor would only be able to enforce its security right up to the amount specified in the security agreement.

65. The aim of this approach is illustrated by the following example. An enterprise has an asset with an estimated market value of $100,000. The enterprise applies for a revolving line of credit facility to a maximum amount of up to $50,000 (including capital, interest and costs). The creditor is willing to extend the loan on the condition that it obtains a security right in the asset. The grantor is agreeable but since the maximum loan amount specified in the security agreement and in the notice is only $50,000 and the asset has a value of $100,000, the grantor may wish to reserve the ability to obtain another secured loan from another creditor later by giving a security right in the same asset relying on the residual value of the asset. Ordinarily, the first-to-register priority rule would deter this subsequent creditor from giving a loan for fear that the first lender could later extend loans beyond the

initial $50,000 for which it would have priority under the general first-to-register rule. By imposing a requirement to specify the maximum value for which the security right may be enforced, the subsequent creditor in this example can be assured that the first-registered secured creditor cannot enforce its security right for an amount greater than $50,000 (including capital, interest and costs), leaving the residual value available to satisfy its own claim should the grantor default.

66. Other secured transactions regimes do not require that the maximum amount for which the security right may be enforced should be specified in the notice. This approach is based on the assumptions that: (a) the first-registered secured creditor is either the optimal long-term financing source or will be more likely to extend financing, especially to small, start-up businesses, if it knows that it will retain its priority with respect to any financing to be provided to the grantor in the future; (b) the grantor will not have sufficient bargaining power to require the first-registered secured creditor to enter a realistic maximum amount in the notice (instead the secured creditor will insist that an inflated amount be included to cover all possible future extensions of credit and the grantor will not usually be in a position to refuse); and (c) a subsequent creditor to whom the grantor applies for financing may be able to negotiate a subordination agreement with the first-registered security creditor for credit extended on the basis of the current amount of residual value in the encumbered asset. The concern with this latter approach is that it may limit the grantor's access to credit from sources other than the first-registered secured creditor even when its assets have a significant residual value in excess of any credit granted or intended to be granted by the first-registered secured creditor.

(b) Maximum monetary amount and impact of error

67. In line with the approach taken in States that already have this requirement, the *Guide* recommends that an incorrect statement in a registered notice of the maximum amount for which a security right may be enforced should not render the notice ineffective (see recommendation 66). Again, this is subject to the caveat that third parties that relied on the incorrect statement of the maximum monetary amount in the registered notice should be protected. Thus, where the maximum amount indicated in the notice is greater than the maximum amount agreed in the security agreement or the amount actually owed, there is no need to protect a third party since its decision to advance funds normally will be based on the amount indicated in the notice. It should be noted that the grantor would also be protected in this situation since it could request the secured creditor or, if the secured creditor failed to act in a timely manner, a judicial or administrative body through a summary proceeding, to amend the notice to correct the amount so that the grantor could obtain financing against the residual value of the encumbered asset (see recommendation 72).

68. However, where the maximum amount indicated in the notice is less than the maximum amount agreed to in the security agreement or the amount actually owed, a third party that relied on the maximum amount specified in the notice (in advancing secured credit on the assumption that it could enforce its security right against any residual value in the asset in excess of the amount indicated in the notice) should be protected. Similarly, a judgement creditor, who took enforcement action in the belief that the excess value of the asset above that stated in the notice would be available to satisfy its judgement claim, should also be protected. The way

to protect the interests of third parties is to limit the right of the secured creditor to enforce its security right as against the third party up to the maximum amount erroneously stated by the secured creditor in the registered notice (as to the rights of the creditor to claim the amount actually owed, see para. 63 above).

[*Note to the Working Group: The only relevant article in the draft model regulations is article 25 but it might be necessary to formulate separate rules for errors made with respect to the duration of registration and the maximum amount along the lines of recommendation 66 of the* Guide.]