

III. MOVABLES REGISTRY DESIGN: WHAT MUST BE REGISTERED

A. Comparison Between Notice-Registration System and Document-Filing System in a Movable Registry

75. Traditional movable registries in some countries require a secured creditor to send a copy of a charge agreement to the registry. The agreement is manually filed under a system that permits retrieval of it on the basis of a criterion such as the debtor's name. When a search is requested, a registry clerk retrieves the contract and provide a copy of it to the person requesting the search or an abstract of its contents. This type of system works reasonably well when volumes of registrations are small and the labor costs are low. However, experience demonstrates that this type of system is not adequate where a significant amount of secured financing occurs.

76. If a movable registry is to provide effective public access to information about potential charges on movable property, it must be accessible, efficient, transparent, and cost effective. Perhaps the most significant design element in achieving these goals is the adoption of a notice-registration as opposed to a document-filing registry.

77. As noted in para. 75, a document-filing registry system involves tendering to the registry office a copy of the actual documentation creating the charge. The registry staff then file these documents in the registry records.

78. Unlike a document-filing registry system, a notice-registration system does not require the actual charge documentation to be filed or even tendered to the movable registry. Instead, secured creditors submit a separate notice of the charge in standard format, setting out only the basic factual particulars needed to alert third parties to the potential existence of a charge against the identified debtor's movable assets.

79. Notice-registration system is preferred to document filing system in the majority of modern movable registry.⁷ There are a number of compelling reasons for this.

80. First, a notice-registration system significantly reduces the registry's administrative and archival costs, owing to the minimal nature of the registered particulars and the fact that they subsist in a standardized notice format, independent of the actual charge documentation. These

⁷ The recently established New Zealand and Viet Nam charge registries are based on notice-registration system. The key registry provisions of the *New Zealand Personal Property Securities Act*, 1999 are set out in Appendix B. The structure and operation of the Viet Nam registry is described in Appendix F.

same factors facilitate the efficient operation of multi-lingual registries and ease transition from a paper notice registry system to an electronic system.

81. Notice-registration system is also preferable from the point of view of reducing transaction costs for registry clientele. Instead of having to work through complex lengthy documentation, third party searchers can quickly and efficiently extract the essential particulars of the charge from the registry. From the point of view of secured creditors, notice-registration substantially reduces their ongoing registration burden. The terms of their security agreement can be amended in response to ongoing circumstances without the secured creditor having to worry about rectifying the registration record so long as the changes do not affect the registered particulars. Indeed, notice registration makes it possible for registration to take place even before the charge transaction is completed, and to have a single registration cover successive agreements between the same parties. These latter two issues are addressed in detail in Chapter V of the Guide.

82. Notice-registration system also responds effectively to the privacy concerns of both debtors and secured creditors. There is an inverse relationship between the amount of information that must be included on the public record and the extent to which the confidentiality of the details of the operations of the relevant parties can be preserved.

B. Transition from Document-Filing to Notice-Registration

83. If a country has initially chosen a document-filing system or already has some form of document-filing system in place, transition issues must be addressed in the course of reform. The simplest approach is to require that all registrations and renewals relating to extant documents that are made after a specified date be effected by registering the form of notice, electronic or paper or both, required by the notice-registration system.

84. Implementation of this approach is straightforward if the effectiveness of registrations under the prior system was subject to a limited, relatively short-term, period. The document-filing and notice-registration systems can simply be left to function side-by-side until expiry of the relevant period of effectiveness. For example, if the old document-filing system provided for a set registration period of 5 years, the old system would remain operational for a maximum period of 5 years after the specified date.

85. The transition is a little more difficult if filings under the old document system were not subject to a set term but were treated as effective until positively discharged. The only feasible solution is to change the law to limit the remaining registration life of extant filings to a specified period, such as for example, 3 years, following implementation of the notice registration system, and to require secured creditors who wish to renew to conform to the new notice-registration system before that time period expires. This approach is workable provided the change in the law is adequately communicated to the extant secured creditors—either directly or through the media—so as to alert them to the need to effect a timely transition to the new system. The only alternative to this approach is for the registry staff to convert the document filings into notice registrations, a labor-intensive exercise, and one that may not be feasible if the notice-registration system requires the entry of information that was not mandatory under the old document filing system. For example, to accommodate computer searching, a new electronic notice system may require the debtor's name to be entered in a more precise fashion than what was the rule under the old document-filing system.

86. The experience of the Canadian province of Saskatchewan illustrates one approach that was successfully used to facilitate transition from a document filing system to a notice

registration system. Under the prereform law of the province, it was necessary to file a copy of each chattel mortgage in a central registry. This filing resulted in a mortgage being effectively registered for a period of 3 years. Another type of secured financing agreement, assignment of book debts, was registered in the same way, but there was no limit on the period of registration. Once a copy of the agreement was filed, the registration remained effective until it was discharged by the secured creditor.

87. A new law, the Personal Property Security Act, came into force which provided for a modern, computerized, notice-registration system. The registration requirements under the new system were very different from those of the old system. Given the large number of registrations in the old system, the government concluded that it would be too costly to have registry staff transpose registrations from the old system into the new one. A different approach was used. This approach placed the obligation to re-register under the new system on secured creditors who had registered their agreements under the old system.

88. The new law did not require immediate re-registration of all agreements registered under the replaced system. It provided that a registration of a chattel mortgage under the old system was to be treated as having been registered under the new system for the balance of the 3 years of the registration under the old system. Consequently, a chattel mortgage that was registered under the old system 1 year before the new system came into effect was treated as being registered under the new system for 2 years without the mortgagee having to do anything. However, this registration would lapse at the end of the 2-year period unless it was actually registered under the new system by the tender of registration notice to the registry before the expiry of that 2-year period.

89. A different approach was required with respect to registered assignments of book debts. The new law provided that all registrations of assignments of book debts would be treated as being registered under the new system for a period of 3 years. These registrations would lapse at the end of this period unless they were actually registered under the new system.

90. The new law was designed to address another problem. Under the old law, it was not necessary to register leases of movables in any registry. However, the new law required that leases of movables having a term of more than one year must be registered in the registry established under the new law. In order to provide for a transition from the old system to the new one, leases having a term of more than one year that were entered into before the new law came into effect were treated as having been registered under the new system for a period of one year. These registrations would lapse at the end of the one-year period unless they were actually registered under the new system.

91. This approach worked very well. However, its success was dependent upon users of the new system being aware of the implications of this approach to transition. Secured creditors and lessors had to be aware of the necessity to re-register, in the case of chattel mortgages and assignments of book debts, or register, in the case of leases, their interest during the grace periods allowed. In addition, persons searching the registry to determine whether or not a chattel mortgage or assignment of book debts had been given by a particular person, had to be aware of the necessity to search both the old and the new registries during the 3-year grace period. Persons who needed to know whether or not movable property was held under a lease could not rely on the registry during the 1-year period after the new law came into effect since, as noted in the preceding paragraph, such leases were treated as being registered during that period even though they were not, in fact, registered.

92. The success of the approach to transition from a document filing system to a notice-registration system used in Saskatchewan can be attributed in large part to measures taken by the government to inform users of the system of the necessity to take into account the extra measures required during the transition period.

C. Access to Further Information in a Notice-Based Movables Registry

93. Even though the secured creditor's priority in a notice-based movables registry is retroactive to the date of registration, the registered notice does not evidence the actual existence of a charge agreement between the parties. It merely gives notice that the debtor may have created a charge in the relevant assets. The actual existence and extent of the charge depends on off-record evidence of the security agreement and its current status.

94. Registry searchers in the position of prospective buyers and prospective secured creditors will normally be able to take the steps necessary to address the legal risk associated with acquiring an interest in assets covered by a registered charge without having to investigate the off-record evidence of that charge. They may refuse to deal further with the debtor, or require a discharge of the registration (in cases where the registration does not support an extant charge), or buy out the position of the registered charge holder.

95. However, the position is different for existing creditors of the debtor, for their representatives such as an insolvency administrator, and for third parties with an existing ownership interest in the charged collateral. For these classes of third parties, the debtor may not be an available or reliable source of information. To meet their informational needs, it is desirable for the secured transactions regime to provide a summary procedure requiring the secured creditor of record, in response to a demand from third parties within these categories, to directly confirm the nature, details and current status of its charge relationship with the debtor.⁸

D. Minimum Content of Registered Notice in a Notice-Based Movables Registry

96. A notice-based movables registry is predicated on the assumption that there is no need for public disclosure of the detailed aspects of the relationship between the secured creditor and the debtor. Indeed, the more minimal the information required to be set out in the notice, the greater the privacy protection, and the lower the risk of error in entry of the registration information.

97. There are compelling reasons to include the identity of the debtor in the registration particulars. As explained in detail in Chapter IV of the Guide, the debtor's name (or other identifier) is the principal criterion used for searching the records of a general movables registry. The debtor's address particulars should also be included, both to assist in debtor identification, and to enable interested third party searchers to locate the debtor for the purposes of demanding further information.

98. In a notice registration system, identification of the name and address of the secured creditor is also essential. After all, the secured creditor is the ultimate source of reliable information about the actual existence of a charge agreement for existing creditors, their representatives, and others with an existing interest in the charged assets.

⁸ For example, see section 77 of the New Zealand Personal Properties Securities Act, 1999, reproduced in Appendix B.

99. In theory it would be possible to have a movables registry that simply recorded the identity of the parties without giving any further particulars as to the nature of the movable assets covered by the charge. However, such a system would require third parties to contact the parties directly in every case to verify the scope of the actual collateral covered by the registered notice. This added inquiry burden would diminish the publicity value and therefore the efficiency of the system. Furthermore, it would increase the likelihood of legal challenges questioning the authenticity of the off-record information relating to the scope of the collateral.

100. For these reasons, a description of the collateral is typically considered an essential element of the registered particulars in a notice-registration system. However, there is room for variation on the nature and specificity of the required collateral description. This important issue is taken up later in the Guide, in Chapter V.

E. Additional Registered Particulars in a Notice-Based Movables Registry: Value of Secured Obligation

101. If secured creditors were required to disclose the financial details of the credit obligation in the registered notice, the benefits associated with advance registration could not be made available. More importantly, such a requirement is commercially unworkable in view of the modern day prevalence of indeterminate credit obligations, such as lines of credit and credit facilities for ongoing advances. In any event, the value of publicizing such information would be limited. With the passage of time, the financial particulars are apt to change and it would be administratively unworkable to require the secured creditor to maintain an up-to-date public record.

102. However, some regimes require the registered notice to disclose the maximum value of the obligation capable of being secured by the charge. The idea behind this requirement is to facilitate the debtor's access to future financing from other secured creditors using the residual value of its charged property as collateral. In the absence of such a limitation, later secured creditors will be reluctant to lend on the strength of the residual value of the collateral. This is because the first registered creditor may later decide to advance further credit to the debtor to be secured by the same charge. In a system that permits a single registration to cover successive agreements between the same parties, this risk exists even if the original agreement with the first registered creditor does not explicitly authorize later credit to be secured by the charge.

103. The scenario that follows illustrates the practical consequences of a system that does not require the maximum value of the secured obligation to be disclosed in the notice that is registered in the movables registry.

Box III-1

Scenario 7: Practical Effect of Absence of any Requirement to Disclose the Maximum Potential Value of the Secured Obligation in the Notice Registered in a Movables Registry

On 1 June, Debtor obtains a line of credit for her business from Secured Creditor 1 secured by a charge in Debtor's inventory and equipment. The agreement provides for a stated maximum of credit (50,000). However, the nature of debtor's business prospects makes it difficult to accurately predict the total amount of the credit that might eventually be extended. Consequently, the agreement gives Secured Creditor 1 the discretion to advance additional amounts in excess of the stated maximum.

On 1 July, Debtor is in need of additional financing for her business. She approaches Secured Creditor 2, who is offering more competitive interest rates than Secured Creditor 1, offering to grant a charge in her inventory and equipment. Debtor acknowledges that she has already granted a charge in the same collateral to Secured Creditor 1, but explains that the current value of the collateral – 100,000- is four times in excess of her actual current indebtedness to Secured Creditor 1 (25,000).

However, Secured Creditor 2 points out that there is a risk that Secured Creditor 1 might later increase Debtor's credit facility to an amount that equals the value of the collateral. To protect itself against this risk, Secured Creditor 1 refuses to grant the loan unless Debtor obtains from Secured Creditor 1 an explicit waiver of its priority with respect to any such later advances in favor of Secured Creditor 2.

104. It is sometimes pointed out that in a competitive credit market, the need to obtain an explicit waiver in this scenario should not be burdensome. After all, Debtor can simply threaten to terminate its credit relationship with Secured Creditor 1 by borrowing sufficient funds from Secured Creditor 2 to pay out the full amount of its existing indebtedness to Secured Creditor 1.

105. However, even in a competitive market, the debtor's practical leverage will be limited if Debtor is required to pay a financial penalty for the right to accelerate payment under its agreement with Secured Creditor 1. If the cost of this financial penalty is equal to the economic benefit of the lower financing rate available from Secured Creditor 2, there is no competitive incentive for Secured Creditor 1 to either grant a waiver or reduce its own interest costs.

106. On the other hand, a system that requires a secured creditor to specify the maximum sum to be secured at the outset greatly reduces the parties' flexibility to adjust the financing arrangement in the light of new circumstances. In the absence of such a requirement, the first registered secured creditor can agree with the debtor to increase the credit facility, or even enter into wholly new credit arrangements, without fear of losing priority with respect to sums advanced under the new terms and without incurring additional registration costs.

107. Alternatively, the parties can always agree to a maximum sum that is sufficiently high to accommodate any conceivable need for a later increase in the value of the secured obligation. However, if inflated estimates are routinely registered, this effectively undermines the objective of the requirement – to preserve the debtor's ability to charge the residual value of the same collateral in favor of later creditors.

108. The scenario that follows illustrates why the likelihood of inflated estimates may have no practical benefit in protecting the debtor's ability to use the residual value of its already charged collateral to obtain access to more competitive credit from other sources.

Box III-2**Scenario 8: Practical Effect of Requirement to Disclose the Maximum Value of Secured Obligation in the Notice registered in a Movables Registry**

On 1 June, Debtor obtains a line of credit for her business from Secured Creditor 1 secured by a charge in Debtor's inventory and equipment. The agreement provides for a stated maximum of credit (50,000), but gives Secured Creditor 1 discretion to advance additional amounts in excess of the stated maximum.

The applicable secured transactions registration regime requires the maximum value of the obligation secured by a charge to be indicated in the registered notice of charge.

In fact, the nature of debtor's business prospects makes it difficult to accurately predict the total amount of the credit that might eventually be extended. To preserve its registered priority, and to avoid the costs of having to make a new registration to accommodate the potential discretionary advance of a sum larger than the maximum stated, Secured Creditor 1 specifies a maximum value in the registered notice (100,000) that is far in excess of the maximum amount stated in the agreement (50,000).

On 1 July, Debtor is in need of additional financing for her business. She approaches Secured Creditor 2 offering to grant a charge in her inventory and equipment. Debtor acknowledges that she has already granted a charge in the same collateral to Secured Creditor 1, but explains that the current value of the collateral – 100,000 – is four times in excess of her actual current indebtedness to Secured Creditor 1 (25,000).

Secured Creditor 2 points out that, according to the maximum amount stated on the registered notice, the current value of the collateral is equal to the maximum amount of the credit capable of being secured by Secured Creditor 1's charge. To protect itself against the risk that Secured Creditor 1 might later increase Debtor's credit facility, Secured Creditor 2 refuses to grant the loan unless Debtor obtains an explicit waiver of priority from Secured Creditor 1 in favor of Secured Creditor 2.

109. The risk illustrated in this scenario does not pose a problem if the debtor has sufficiently strong bargaining power to prevent the registration of a grossly inflated maximum amount. However, debtors rarely bargain from a position of strength. Accordingly, if policymakers decide to impose a maximum value registration requirement, they should also provide some procedure to enable the debtor to require the registered amount to be reduced where it does not reflect the actual obligation owed to the secured creditor under any existing agreement between them. Otherwise, the presence of this requirement will simply complicate the registration process, and increase the risk of error, without producing any real benefit for debtors.

F. Additional Registered Particulars in a Notice-Based Movables Registry: Duration of Registration

110. In some systems, all registrations are treated as effective for a uniform fixed term of years and must be renewed if the charge agreement continues in effect beyond the expiry of that term. The disadvantage of a fixed term approach is that the natural life span of a financing relationship is not uniform from one transaction to the next. Although secured loans to finance the acquisition of charged collateral are typically short term (3 to 5 years), a bank extending general working capital financing to a commercial customer may anticipate a relationship extending over several decades. In view of these variations, the stipulated fixed term is apt to be either too short or too long for most transactions. Where the term is too short, secured creditors face the risk that an inadvertent failure to effect a timely renewal will result in a loss of priority. Where the term is too long, the registry record becomes cluttered with stale registrations. The archival burden this imposes on the registry is less serious if the registry record is maintained in

electronic as opposed to paper format since storage costs will be minimal. Nonetheless, the persistence of stale registrations on the record should be discouraged regardless of the nature of the record, since they prejudice the ability of the named debtors to deal with the assets alleged to be still charged.

111. To facilitate a closer match between the duration of registration life and the duration of the charge relationship, a number of regimes permit secured creditors to select for themselves the term of the initial registration (while also permitting renewals in the event circumstances change). In such systems, the duration of the registration will be part of the mandatory registration particulars.

112. Self-selection of the registration does not completely alleviate the problem of stale registrations since some secured parties may be tempted to select an inappropriately lengthy registration period out of an excess of caution. However, two proven techniques are available to reduce this risk. First, registration fees can be calculated by reference to the length of the registration term selected by the secured party so as to discourage secured creditors from attempting to pass on registration fees to the debtor that are excessive relative to the value and anticipated real duration of the financing relationship. Second, a secured creditor can be placed under a legal obligation to discharge any registrations that does not represent an extant charge, backed up by a financial penalty for breach and a simple low-cost procedure enabling the named debtor to unilaterally compel discharge of the registration.⁹

G. Should the Debtor's Signature or Consent be required in a Notice-Based Movable Registry?

113. A registered notice of a charge where none in fact exists or is contemplated may have a negative impact on the alleged debtor's perceived creditworthiness. Should the secured creditor therefore be required to obtain the debtor's signature on the registered notice as evidence of its authority to register? Such a requirement is incompatible with the efficient administration of a computerized registry. More importantly, it creates unnecessary transaction costs and risk of error for secured creditors, since the concern underlying the requirement can be more efficiently dealt with in other ways. One possibility is to impose a legal obligation on secured creditors to obtain a written record of the debtor's consent or waiver of objection to registration. This provides more than adequate protection for debtors if backed up by a financial penalty for breach and a summary procedure whereby the named debtor can unilaterally compel discharge of the registration.¹⁰

⁹ For example, see sections 161-169 of the *New Zealand Personal Property Securities Act, 1999* reproduced in Appendix B. See, also, section 44(1) of *The Saskatchewan Personal Property Security Act, 1993*, c. P-6.1, s. 35(7) and section 4(1) of the Saskatchewan Personal Property Security Regulations, P-6.1 Reg.1. This legislation is reproduced at: www.qp.gov.sk.ca.

¹⁰ For example, see sections 161-169 of the *New Zealand Personal Property Securities Act, 1999*, reproduced in Appendix B.