

CIDIP-VII: The Drafting of a Registry Component for the Model Inter-American Law on Secured Transactions

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I. Procedural History

The Organization of American States, at the Sixth Inter-American Conference on Private International Law in 2002, adopted the Model Inter-American Law on Secured Transactions – a document aimed at reforming the domestic legal frameworks of member states to permit taking security in personal property collateral. The Seventh Conference on Private International Law will focus on creating uniform registration forms and model registration rules to fulfill the perfection and notice requirements of the Model Law.

II. Introduction

All modern secured financing laws require that a secured party “perfect” its security interests—an action mainly consisting of notifying third parties that a debtor’s personal property serves as collateral for a loan. Given that these laws must also follow some variation of the “*first-in-time rule*,” the first secured party to perfect and give notice will receive priority vis-à-vis subsequent secured parties and buyers. The most common method for perfection is registration, which gives constructive notice via a record in a public office and which is available for most types of security interests. In fact, in most cases, registration is the only permissible way to perfect.

The importance of perfection and priority rises when a debtor cannot, or does not pay the secured party. Here, the secured party will repossess and sell the collateral and apply the sale proceeds to the outstanding loan amount. Perfection, achieved by registration, establishes the priority of the secured party over third parties and allows the secured party to repossess and dispose of collateral.

This study separates the inner-workings of registration into three simple questions: what, when and where to register. Under a modern secured financing system, the short answers are that a secured party should file a financing statement, in a central registry location, as soon as possible, by following modern registry practices. This study compares current Latin American practices to modern registration practices and proposes a system that the CIDIP-VI can use as a model for the secured financing topic.

III. Registry Document

A. Registered Document

1. Current Latin American Practice

Latin American laws create transactional filing systems where what is registered is the complete transactional document, the security agreement between the secured party and the secured debtor. This system makes registration necessary not only to provide notice to third parties, but also, at times, to create a binding security interest between the original parties to the transaction. This registry process usually does not distinguish between commercial and civil transactions and, often, registered documents do not indicate the legal mechanism used to create the security interest in question. This lack of consistency and uniformity makes it difficult to determine the rights of the secured party and fails to establish a

cohesive priority scheme with regard to other secured financing mechanisms, secured parties, buyers and third parties in general.

2. Recommendations

A revised registration system should take into account the need to inform interested third parties and the desirability of reducing the paperwork and rigidity inherent to a transactional filing system. A new system based on notice not transactions should require only enough information to permit a searching third party to identify the parties to a transaction and the property serving as collateral.

Reforms should allow the registration of a financing statement—a registration form summarizing the terms of a security agreement—consisting of information designed to alert third parties that a debtor’s assets may serve as collateral for a loan. A central aim of a new registry scheme is to strike a proper balance between the burden placed on the registering party and the need of searching parties to obtain enough information to make a business decision concerning a particular debtor’s collateral. The best approach is to create a notice filing system that merely notifies third parties that there is (or may be) a security interest in collateral described in the financing statement. Based on a financing system, this registry system should merely require the debtor's name, the secured party's name and a description of the collateral. The financing statement does not overburden a registering party yet provides sufficient information put third parties on notice that further inquiry is needed.

A financing statement should be a simple document or, even, information revealed on a computer screen and should contain only basic information about the secured party, the secured debtor and the collateral. Financing statements should contain no reference to a particular transaction between the parties. Information contained in a financing statement must be limited to the following:

- a) the identification of the secured party(s);
- b) the identification of the secured debtor(s);
- c) a description (either general or specific) of the property taken as collateral; and,
- d) in some jurisdictions, the length of validity of the registration.

B. Collateral Descriptions

1. Current Latin American Practice

The majority of Latin American laws require that the registered document describe the collateral to a loan in “indubitable,” indelible manner—a description frequently compared to the pre-UCC serial-number test. Descriptions this detailed, however, hinder many modern secured financing features. This is especially true regarding security interests that extend to future goods, which do not exist at the time of registration and thus cannot be described in detail. Future advances and floating liens are also rendered inoperable under such descriptions. In addition, certain collateral types including fungible goods cannot be described in such detail due to their generic nature and are *de facto* excluded from the present secured financing system. Lastly, inventory collateral revolves continuously and hence cannot be described in detail.

For instance, if D engages in the sale of appliances, and receives a loan from SP for the purchase of inventory. SP secures its loan with a security interest in the inventory

collateral. Currently, to perfect this security interest, SP must register a document containing a detailed description of each appliance comprising the pool of collateral; this description requirement is generally satisfied with the serial number identification for each appliance. This requirement is not a problem for the original collateral but is an obvious problem down the road. Considering Latin American *in rem* rights, which follow encumbered property to the hands of any third party including bone fide buyers, in order for D to sell an appliance free of the security interest, SP would have to first cancel the original registration covering the appliance sold. Inventory sales would present this scenario hundreds, even thousands of times, during the life of the security interest. Releasing each item sold would be a massive and costly task.

SP is also likely to require payment before releasing its security interest and canceling the registration. In most cases, D will not have the funds to pay SP until D sells the inventory. Consequently, using inventory as collateral is practically impossible under the present registry system.

2. Recommendations

One of the main features of a modern secured financing system is its ability to encumber proceeds and after-acquired property. For a financing statement to cover these goods, and any future goods, the document must describe the collateral in general/generic fashion. General descriptions involve something such as the following examples: all inventory and equipment, all appliances, all future goods, all 'General Electric *easy-clean*' refrigerators, etc. Any types of goods that cannot be described in detail require general descriptions; e.g. accounts receivable, fungible goods and inventory.

A secured financing system that gives legal effect to general/generic descriptions is not inconsistent with civil law tradition and can be implemented in Latin America. However, in order to do so, reforms must ensure that the detailed description requirement is replaced, ensuring the ability of merchants and lenders to engage in secured financing activities with future goods, accounts, inventory, and fungible goods.

C. Index Criterion

1. Current Latin American Practice

In several Latin American countries, the detailed description requirements also serve as the basis for the index of the registry. Registries use descriptions of the collateral as the primary registry-index criteria. Security interests are indexed internally according to a description of the goods that serve as collateral. This method has its origins in real property registries, which use descriptions of the real property as the registry index criteria. With respect to real property, a description-based registry works well; however, a registry based on personal property descriptions creates the following difficulties.

Real property typically has unique legal descriptions that differentiate one parcel of land from all other parcels of land. Personal property, however, typically does not. Third parties interested in real property will have access to its unique description and will be able to use it to search the registry records in search for liens. Third parties interested in particular personal property may not have access to the description of the property if it consists of future or fungible goods. Even if such description is available, they are of little use when searching a registry system for liens. Consequently, collateral-based-indexes produce little benefits with respect to personal property.

2. Recommendations

Modern registries index financing statements according to the debtor's name. This method allows interested parties to search the registry to determine the existence of liens on a particular debtor's property by using the debtor's name. Consequently, adding a debtor's name to a financing statement has important consequences. A name-based index will record security interest alphabetically using the debtor's name. Conversely, a party wishing to buy the debtor's property, or extend credit using such property as security, will conduct a search based on the debtor's name.

Several important features of a secured financing system cannot properly function if based on a collateral-description criterion. Security interests such as in future goods and accounts only function with a system allowing for general collateral descriptions. General collateral descriptions do not specifically identify the goods and therefore do not have the characteristics that can serve as the index criterion. For example, a security agreement may provide for a security interest in personal property that the debtor acquires at a future time; future goods cannot be described, and therefore cannot be indexed based on a description. The same is true of security agreements in accounts. Consequently, a modern registry system can only function when debtor names are used as the registration-search criterion.

D. Advantages of the Financing Statement

A financing statement has several important advantages over the practice of filing the actual security agreement between the parties. First, a financing statement limits the information contained and thereby provides a greater measure of confidentiality of business information than filing the actual agreement between the parties. Second, a single financing statement can relate to one or more secured transactions. A properly drawn financing statement can meet registration requirements for many security agreements between the same parties and cover a period of several years. Moreover, a financing statement can be registered before a security agreement is executed between the parties. Finally, a financing statement facilitates remote-access registration.

A modern registry system contemplates the use of a uniform financing statement. Uniformity assists in harmonizing filing practices within jurisdictions in countries divided into federal entities and serve as a model for the hemisphere.

E. Fixture Filing

When property used as collateral for a loan is adhered or incorporated into real property, the secured party must file an extra document to ensure perfection over previous security interests in the real property. Some goods, when affixed to real property result in giving a party with a previous interest in the real property an additional interest in the goods. These goods are generally referred to as "fixtures," such as a central air conditioning or heating system. Like security interests in any other types of personal property, perfecting a security interest in fixtures requires the registration of a financing statement. However, an additional registration called a "fixture filing" is required to perfect the security interest with regard to real estate claimants.

For a filing to be effective as a fixture filing, a secured party should add to the financing statement an additional statement indicating that it is also filed in the real estate records. This statement should include the description of the real estate to which fixtures are adhered and the name of the owner of the real estate. A description is considered adequate if it reasonably identifies the real estate. Alternatively, states may require that the

description of the real estate satisfy the local law governing descriptions in real estate mortgages, including a legal description.

F. Debtor Signature

A major trend in secured financing reform is the absence of a requirement that the debtor's signature appear on the financing statement. This practice is designed to facilitate electronic filing, whereby the secured party can electronically register a financing statement without the need of relaying the financing statement through the debtor for his signature. Eliminating the signature requirement on the financing statement does not mean that any and all filings are effective. A modern law and/or registry office practices limit who is entitled to file a financing statement, and specify that the debtor must authorize the filing before it can take place. A reform effort that permits filing without the debtor's signature must also impose liability (criminal and civil) for unauthorized filings, and establish procedures for removing unauthorized filings.

IV. Registry Timing Issues

A. Priority

As noted above, perfection is about priority and most priority disputes are decided according to some variation on the "*first-in-time rule*." In other words, the party who files first prevails. Consequently, this question is answered relatively easily: one should file as soon as possible. Ideally, parties should register a financing statement as soon as they are serious about entering into a secured transaction.

B. Registration Timeliness

1. Current Latin American Practice

Under current Latin American Law, a registration is generally effective if the following three conditions are met: 1) the parties present a properly ratified loan document; 2) all registry fees are paid in full; and, 3) a registry official reviews the loan document and determines that it is legally valid. When these conditions are met, the document is recorded in the registry records. Under this system, the time that a financing statement actually shows up in the filing system governs priority even though the document does not appear in the registry records until sometime after the review by the registry official. The difference between the time of presentation and the time the document is registered (frequently referred to as registry-lag) can range from one to three days, and can often take longer.

Important consequences follow from this rule. One is that a registration is effective even if it is not timely registered, or indexed by a registry official, and even if a party searching the registry cannot find the record during the lag-time. Consequently, unknowing third parties may extend credit without being able to know of an existing registration and find themselves in a subordinate position vis-à-vis the registering party.

The following example illustrates the problems created by a registry lag. On March 1, Merchant (D) obtains a loan from Lender (SP) for the purchase of machinery. The same day, SP presents a financing statement encumbering D's machinery as collateral for the loan. On March 2, 2000, a third party (3P) interested in purchasing D's machinery makes an inquiry at the registry to determine whether there are any encumbrances against D's machinery. Given that the average lag between presentation and registration is 2 to 3 days, it is possible that SP security interest does not appear on record until March 3. Consequently, 3P may rely on its inquiry of the day before and purchase D's machinery. However, SP's security interest in the machinery is considered valid from the date of presentation, not the date of actual recordation. Therefore, 3P's rights to the machinery it bought in good faith are subordinate to the prior

interest, even though 3P relied on what appeared as a proper registry search. If the time between presentation and registration is more than a few days, there is an increased probability that subsequent searches fail to uncover the existence of valid liens. Registry offices in some countries file preventive (interim) notice, which alerts searching parties that a registration may take place in the near future.

2. Recommendations

A modern system, where a financing statement is registered (not the transactional document), eliminates the need to review and qualify registry documents. Consequently, there is no lag time between communication of a financing statement to the filing office and actual indexing.

C. Pre-Filing

1. Current Latin American Practice

Pre-filing refers to the practice of registering a financing statement either before the parties sign a security agreement or before the secured party advances funds to the debtor. This is accomplished by not requiring that the agreement itself be recorded—or even have been executed—at the time of registration, and by conditioning the registration purely on the debtor's willingness to authorize the registration of a financing statement. Current Latin American practices require the registration of the security agreement, thereby hindering all pre-filing practices.

2. Recommendations

A modern system allows the parties to file a financing statement before executing a security agreement. Various important modern financing activities including future advances, lines of credit and floating liens depend on the ability to pre-file. Additionally, when contemplating, negotiating or structuring a secured transaction, pre-filing allows the parties to file early to lock-up a specific priority, giving the parties one less issue of concern as they conclude a loan agreement.

D. Future Advances, Credit Lines and Floating Liens

1. Current Latin American Practice

Most Latin American Countries require that loan amounts be certain as to date and amount before they are legally binding and valid. Consequently, current registry systems will permit registrations that cover open credit line and other types of future advances.

2. Recommendations

Future advances are funds disbursed by a lender to a debtor after the date of the agreement or the date of registration, or both. Credit lines are typical examples of future advances where a debtor has flexibility concerning both the amount drawn on the credit and the date on which the draw takes place. Another important use of future advances is the floating lien. A floating lien allows both the collateral and the secured obligation to fluctuate. With the floating lien, a secured party obtains a security interest in a fluctuating fund of present and future collateral. In turn, a debtor obtains access to a fluctuating line of present and future funds.

In order to permit secured lines of credit and floating liens, secured financing reforms must allow a registered financing statement to encumber future advances. That is, to allow a secured party to register and perfect a security interest before actually advancing funds to the debtor. This is accomplished by allowing pre-filing.

Pre-filing also allows the parties to a secured transaction to establish a priority position and proceed with loan negotiations without concern that priority will be lost between the time when negotiations began and the date of perfection. The following scenario demonstrates the practical significance of pre-filing: Merchant (D) seeks to finance commercial activities and approaches lender (SP) for a loan. SP immediately registers a financing statement describing D as a debtor and specifying kinds of property of D as collateral. SP then obtains a search result that displays the priority position that his registration would establish if he were to loan money to D. After a period of negotiations between the parties, an agreement is obtained and a security agreement is executed. Since SP has already registered his financing statement and knows his priority position, he can immediately release the money to D

V. Registry Location

A. Place of Registration

1. Current Latin American Practice

Under Latin American law, there are many answers to the question *where* to register a security interest. Each Latin American country's secured financing framework is composed of many different security mechanisms. The method for perfection differs for each of these mechanisms. Even those that require registration provide for different registry locations. As a rule, most secured transactions are registered in the jurisdiction in which the collateral is located. Yet, in other cases, the parties can choose to register at either the debtor's place of residence, the lender's place of residence, the jurisdiction in which the collateral is located, or the jurisdiction in which the parties executed the security agreement. Other security mechanisms allow the parties to set the registration locale by agreement. A common practice, in many jurisdictions, is to register at the secured party's place of residence. This practice is probably due more to convenience than any other factor.

2. Recommendations

The best answer to the *where-to-register* question is to create a single filing location; a central database that contains all registered financing statements. A central system is possible in most Latin American countries, including Argentina, Brazil and Mexico. Even though these countries employ a federalist system of government where the states have jurisdiction over many matters, each allows federal jurisdiction over commercial/mercantile transactions including secured loans. Hence, all Latin American countries can enact federal legislation that provides for a federal centralized registry.

The federal centralized registry would then be the only place to file a security interest and could be accessible from throughout the country, including via state registry offices. Interested third parties could determine whether a particular debtor has any liens of record in the entire state, region or even country, by consulting a central registry.

Fixture filings present an exception to this central filing rule. As mentioned in Section III E, fixtures require an additional step for perfection—filing in the real property registry. Real property liens and encumbrances are located in the jurisdiction in which the real property is located. Although some real property may be located in the central jurisdiction, much of the real property will be located in an outside jurisdiction. Consequently, a party with a security interest in fixtures adhered to real property located in a location outside the central jurisdiction must file its security interest in the real property registry for such jurisdiction. As to *all* other cases, filing should be central, meaning in a centrally designated office or central database.

B. State vs. Federal Registries

1. Current Latin American Practice

In Latin American countries with a Federalist system of government (Argentina, Brazil, Canada, Mexico and the U.S.), registry jurisdiction resides at the local state level. Some states also frequently divide the local registry system into county/judicial districts. Each state and each district within the state always has its own public registry. Consequently, the where to register question has two parts. The first is in which state should a registration take place. The second is where, within the state, should the registration take place. As mentioned in section A, the answers to such questions are not always clear and may vary.

Generally, each registry is autonomous and not linked to other state or district registries. When coupled with discretionary rules for determining the filing location, the lack of links between registries and the lack of a central database can cause great problems for searching parties. Generally, it is very difficult for a searching party to locate a properly recorded lien unless he can determine the location in which the parties actually registered and conducts an inquiry at that filing office.

For example, merchant (D) incorporated with its principal place of business in Guadalajara, Jalisco, Mexico, obtains a loan for the purchase of machinery and equipment from lender (SP) incorporated and located in Monterrey, Nuevo Leon, Mexico. After creation and perfection of the loan, a Mexico City corporation (3P) is interested in acquiring D's machinery. 3P attempting to determine if there is an existing interest in D's machinery would likely consult the registry in Guadalajara. However, SP may have registered its interest at the registry in Monterrey, making the search of the Guadalajara registry futile.

In Mexico, and ostensibly in Argentina and Brazil, a registration that follows existing rules is valid throughout the state and even throughout the country. Consequently, if 3P purchases D's machinery relying on the fact that the search in D's place of residence did not disclose the existence of SP's lien, his rights are subordinated to those of SP.

C. Special Registry

With respect to specialized collateral, such as very valuable equipment or goods affixed to real estate, the where to register question yields two registry locations. Security interests in these types of collateral require filing in specialized registry in addition to registration in the traditional secured interest registry system. The rationale behind this extra requirement involves the relative weakness of the traditional registry system: using the debtor's name as the sole registration criterion. Such system works well if collateral is present and future inventory or accounts. It works less well, however, if the collateral is a specific item, such as a large piece of equipment that is easily identifiable. Using a registry based on debtor names does not protect third parties that are not aware of the existence or identity of the secured debtor.

Such a problem is presented when a lender (SP) perfects a security interest in, for instance, an industrial sewing machine belonging to manufacturer (A). A then transfers the machine to third party (B) without notifying the secured party or filing a proper financing statement under B's name. A subsequent party that buys or lends to B will have little chance of discovering the SP's security interest. Using the traditional registry system, buyer would search under B's name, not A's. In this circumstance, a specialized registry would provide better notice because the registry-search criterion would be based on the description of the sewing machine, not A's name. For example, instead of searching for a lien on "B's sewing machine," buyer would search for a lien on *Singer sews-a-lot* sewing machine serial number

12345. Considering the collateral-specific nature of a specialized registry, the buyer will discover SP's security interest regardless of who is in possession of the collateral at the time of the search.

A modern secured financing system requires a special registration for the following types of collateral: personal property adhered or incorporated into real property; aircraft and boats; motor vehicles; valuable equipment, and, other collateral, which according to national legislation or international treaties, require a special registration.

VI. Additional Recommendations

A. Presentation before the Registry

1. Current Latin American System

The first step that a secured party, or other registering party, takes in the registration process is to present the financing statement to the registry office. Currently in Latin America, most registry offices require that registering parties appear in person to present registration-bound documents.

2. Recommendations

A revised system should accommodate in-person presentation as well as alternative methods for presentation including various forms of electronic transmittal. For instance, reforms should allow presentation via mail, fax, modem, courier, EDI, etc. Ideally, reforms should be based on the guidelines established by the UNCITRAL Model Law on Electronic Commerce, which also permits presentation by "any other method which is accessible for later consultation and which can be produced in a tangible form recognized by law or custom."

B. Legal Review Requirement

1. Current Latin American System

Under the present system, once the parties appear before the registrar and present the transactional document, a registry official determines whether the document complies with all legal and procedural requirements. If the document passes this evaluation, it proceeds to registry records. If it does not, it is rejected and returned to the registering party. As discussed earlier, the time in which the evaluation process takes place ranges from several hours to a few days. Once the evaluation is complete and the document approved for registration, the documents are integrated into portfolios and filed chronologically.

2. Recommendations

Reforms should eliminate the current registry review and qualification procedure. Since a new system would be based on financing statements, not loan agreements, the need for review and qualification would be greatly reduced. As explained in section VI (I) below, not all registry review can be eliminated. However, review should not determine the legal validity of the registered document and should be limited to determine whether the registering party presented the financing statement to the registry office, paid all applicable fees, and provided information that may be used to identify a debtor, secured party and collateral.

C. Registry Index System

Once presented, reviewed and accepted, financing statements are index based on the debtor's name. For example, where the correct name is Smith, the financing statement should be indexed alphabetically with the names beginning with "S." A searcher contemplating extending secured credit to this debtor should search under the name "Smith."

For this type of system to work, both the secured party and the searcher must use the same name. If the secured party uses one name and a searcher another, obvious problems result. Deciding upon the correct name can sometimes present unforeseen difficulties. For example, determining the debtor's name is difficult in cases where the debtor is an individual that uses an alias, where the debtor is a business entity that is not filed with the state, and where the debtor operates under an assumed or trade name. Additionally these complications can be compounded by the relative ease with which a debtor may change his name.

Generally, reforms address essentially two situations: namely, when the debtor is an individual and when the debtor is a registered business entity. Possible solutions require the debtors' true name. In cases where the debtor is an individual, the financing statement should contain the debtor's true given name. In cases where the debtor is a business entity, the financing statement should contain the legal individual, partnership or corporate name, whether or not the debtor uses, and the financing statement contains, other trade names or names of partners.

D. Identification of the Collateral

The description of the collateral, as contained in a financing statement, informs interested third parties that certain property is subject to a perfected security interest. Nevertheless, considering that modern registry systems employ a "notice filing" approach, the information provided will not necessarily be complete concerning the exact property subject to a security interest and other terms. Instead, searchers are only put on notice that another party may have a security interest in property the searcher is considering as collateral and that further inquiry is required.

Typically, the description requirement is satisfied if the financing statement contains a general/generic description of the collateral. Alternatively, the financing statement may describe the collateral as specific items. In other words, any description of personal property collateral is sufficient, whether or not it is specific, if it serves to identify the goods subject to a security interest. Additionally, a financing statement should include a special notation or description in cases where a security interest covers complete categories of a particular collateral type (e.g. all inventory, all equipment, all general electric appliances, all accounts receivable, etc.). A similar notation should also be required when a security interest covers all of the debtor's assets or personal property (e.g. all assets, all present and future goods, etc.). In the event that the parties do not intend that a security interest encumber all the debtor's personal property, the parties may choose a universal description such as "all assets," but may limit its scope (e.g., all assets other than automobiles).

E. Signature Requirement

1. Present Latin American Practices

Currently, Latin American registry systems are highly formalistic requiring written signatures, notarization and ratification. Eliminating these requirements is likely to be a difficult. Fortunately, many countries have begun to implement rules regarding electronic

signatures and are thus setting the foundation for a simpler (less formalistic) registration system. This trend in reducing the need for, and number of, signatures will result in improved speed and efficiency. However, some Latin legal experts argue that such efficiency sacrifices important safeguards aimed at reducing bad faith on behalf of the contracting parties.

2. Recommendations

As discussed in section III (F), electronic registration has created a system that is most efficient if the electronic financing statement contains only the signature of the secured party (or registering party) and not that of the debtor. Paper-based registration protected a debtor from unauthorized filings by requiring his signature on the financing statement. Reforms can provide this same protection by implementing controls on a registering party's registration activity and penalizing negligent or malicious filings.

F. Discrepancies, Mistakes and Common Names

Discrepancies and mistakes in registration systems are inevitable, such as misspellings, incorrect names, etc. A registry system aims for reliable accurate records. However, a registry system that uniformly rejects registrations containing mistakes has serious drawbacks. Preferably, reforms should protect secured parties whose mistakes can be rectified, particularly with regard to the debtor's name.

Common mistakes can be made worse when registry search criteria is too specific, such as a criteria that reveals only exact matches. For example, if the debtor's name is John Smith, an exact match registry will not disclose the registration if the registration is under John M. Smith, Jon Smith, Jonathan Smith, etc. Consequently, a system that automatically discards registrations because of discrepancies creates its own set of problems. Instead, a modern registry system has the means to respond to common errors and avoid being overly formalistic.

Searches by debtor name often result in multiple matches. This is especially true with common names. A party searching the registry may have to sort through numerous records to determine a match. This problem is often addressed by use of some criteria to distinguish financing statements of different debtors having the same or similar names. For instance, use of social security numbers, or taxpayer identification numbers, to identify debtors on financing statements may reduce the frequency of these problems.

A possible response to processing financing statements with common errors is to allow a financing statement to perfect a security interest if the errors are not seriously misleading. However, problems arise when trying to define an error as minor or major. Civil law systems are particularly rigid with regard to these types of determinations and may not allow for a common law based "seriously misleading" rule. However, civil law countries could follow a rule that states that an error is "*major*" if it prevents a searcher, who conducts a proper search, from gaining access to the correct financing statement.

G. Correction of Registry Errors

Although some errors and discrepancies are inevitable and should be managed, the functioning of a registry system can be undermined if there is no method for correcting these errors. Preferably, a registry system should provide the parties, a document containing the terms of the financing statement as they would appear to a searching party. This document is called a verification statement and can be transmitted by the registry office to all parties named on the presented financing statement. The parties to the

transaction are provided an opportunity to review the information and correct any discrepancies or mistakes.

H. Fraudulent and Mistaken Registrations

In addition to correcting registry errors, verification statements can lessen the likelihood of fraudulent or mistaken registrations. As discussed in sections III (F) and VI (E) above, a modern registry system does not require the debtor's signature. However, removing the debtor from the direct registration process increases the opportunity for fraudulent or mistaken encumbrance of the assets of an unknowing innocent debtor. A debtor must be notified when his collateral is encumbered with a security interest and, consequently, the registry system must provide a method for notifying these parties. Preferably, the registry system should provide the debtor with a copy of the verification statement, which refers to the financing statement indexed under the debtor's name. In cases of a mistaken or fraudulent filing, the debtor should be provided the means to contest the validity of the financing statement. Reforms should penalize fraudulent and repetitive mistaken registrations in order to reduce their occurrence.

I. Acceptance and Validity of Financing Statements

1. Current Latin American System

Latin American law requires that the parties to a secured transaction register the entire security agreement. The registrar reviews and qualifies the security agreement to ensure its legal validity and registration-worthiness. Documents that pass this qualification test are accepted, registered and considered legally valid. All others are not.

2. Recommendations

Reforms would result in the registration of a one-page financing statement, not the entire document. Consequently, a modern system eliminates the need for registrars to review the terms and legal validity of a security agreement. This summary procedure does not entirely remove the registrars from determining whether a document is (or is not) fit for registration. For instance, the registrar should reject a financing statement that does not identify the debtor, the secured party and the collateral. In practice, computerized systems can scan for these features and reject financing statements that are not complete. Conversely, a financing statement that identifies the debtor, the secured party and the collateral should be registered without further inquiry by the registry system or the registrar.

Reforms to a registry system should only allow a registrar to reject a financing statement for the following reasons:

- 1) If the financing statement is communicated by a method or medium of communication not authorized by the registry system;
- 2) If the applicable registry fee is not paid in full;
- 3) If the financing statement does not provide a name and mailing address of the debtor;
- 4) If the financing statement does not provide a name and mailing address of the secured party;

5) If the financing statement does not describe the collateral encumbered by the security interest, (note: the general description requirement should permit one character descriptions); or,

6) If the registrar is unable to read or decipher the financing statement.

If one or more of these reasons are present, a registrar should reject the financing statement. The authority to reject a financing statement because of these deficiencies are essential to ensure the ability of a registry office to perform its duties (deficiencies 1 and 2), as well as the effectiveness of the registry to permit a searcher to discover that certain property is subject to a security interest (deficiencies 3 through 6).

Even if a financing statement contains the items required to be registration-worthy does not mean that the document is legally valid. A financing statement may be suitable for registration yet be unenforceable. For example, a financing statement that identifies John Smith as the debtor, First Bank as the secured party, and all of John's refrigerators as the collateral provides sufficient information for registration, if it also complies with the other requirements. However, if the financing statement contains errors such as the wrong debtor (not John Smith), or describes the wrong collateral (not refrigerators), it would not be enforceable.

In the event that a registrar rejects a financing statement when it is obliged to accept or accepts a financing statement when it should have rejected it, may result in an effective registration. If a rejected financing statement should have been registered, it is effective except in the event the collateral was purchased by a buyer who gives value in reliance on the absence of a registered financing statement. In contrast, if a financing statement is registered but should have been rejected, it is subordinate to the rights of a holder of a perfected security interest in (or a buyer of) the collateral to the extent that the holder of the perfected security interest or buyer gives value in reliance on the incorrect information.

When a financing statement is rejected, the registry system should promptly notify the person that presented the document. This notification should contain the reason(s) why the document was rejected as well as the date and time the record would have been registered had the registry office accepted it.

J. Further Inquiry Requirements

Under a notice-filing approach, a registered financing statement merely informs third parties that certain property of a debtor is encumbered. Third parties are thus required to inquire further, even though the steps to obtain further information are not always readily apparent, especially to unsophisticated third parties.

Notice filing systems under the Uniform Commercial Code (UCC), which provided general rules concerning the 'further inquiry' dilemma, serve as a model for registry reforms in Latin America. First, a notice-filing approach operates on the basic assumption that a debtor has an interest in providing further information. Generally, the debtor intends to form a relationship with the interested third party, either to receive a loan or to sell its goods. Consequently, the debtor has an interest in providing information to the third party. If no such interest exists, the debtor need not do anything to make the third party's inquiry successful. Conversely, if the debtor desires to borrow from, or sell to, a third party, a large part of the 'further inquiry' burden should be placed on the debtor because of the debtor's interest in the needed information.

Modern secured financing laws allow a debtor to draft a statement indicating what the debtor believes to be the aggregate amount of unpaid indebtedness (as of a specified date) and may send it to the secured party with a request that the statement be approved or corrected and returned to the debtor. This statement provides the debtor useful information that may be shared with future commercial transactions. Similarly, since a financing statement identifies encumbered collateral, a debtor may request the secured party to approve or correct a list of the collateral subject to the existing security interest. The debtor may also use this document in connection with commercial transactions with third parties.

A modern system obligates the secured party to comply with a debtor's requests and cooperate in his dealings with the third party. A secured financing system may also provide that if the secured party fails to comply with a request, the secured party may be liable for any loss caused to the debtor. If the secured party has no further interest in the obligation or collateral at the time the request is received, that must be disclosed to the debtor. In cases where the obligation was transferred, the original secured party must disclose the name and address of the transferee who holds the secured interest.

K. Life of a Financing Statement

Modern technology allows financing statements operate indefinitely. In some Canadian provinces, 'infinity registrations' are permitted for a fee. However, most registrations are tailored to the expected life of a particular transaction. In contrast, under the UCC system in the United States, financing statements generally cease to be effective after five years. To be effective beyond the five-year period, the secured party must file a continuation statement before the lapse of original five-year life span.

The UCC five-year limit is based on space concerns. Space concerns are essentially eliminated by electronic registry systems—electronic registries can store thousands of records in the same space required for just a few paper files. Consequently, it is possible to allow a secured party to choose the duration of the registration including perpetual or indefinite periods.

Concern has been raised that allowing the parties to choose an extended period of time of a registration (as in the Canadian system), as opposed to statutorily establishing the registration period (as in the U.S. system), may lead to abuses in the form of unnecessarily long registrations. These abuses, however, can be limited by basing the fee on the term of validity—the longer the term, the higher the cost. Additionally, a registry system that provides for flexible registration periods should also allow a debtor to cancel a financing statement upon proof of complete payment or proof that the length of validity misrepresents the terms of the security agreement.

Finally, as we saw in section IV (C-D), a financing statement can apply to future disbursements and can include constantly fluctuating obligations. Consequently, a financing statement will apply to future loans even if the debtor does not presently owe a secured debt as long as the terms of the financing statement can apply to future transactions. In order to end this automatic ability of the financing statement to serve to secure future debts, the parties must cancel the end original registration.

L. Cost of Registration

1. Current Latin American System

Most Latin American registries calculate the cost of registration as a percentage of the secured loan amount. Some countries set a ceiling amount that ranges between \$3,000 and \$5,000 dollars. In contrast, filing fees in the U.S. and Canada generally range from \$5 to \$25 dollars. In Latin America, the registration fee functions not as a fee but as a tax on the value of the loan and is used, not for registry office costs and improvements, but for a wide array of governmental programs. Given the lucrative nature of this taxing practice, it is unlikely that Latin American countries will reduce the filing fee on any sort of substantial basis.

2. Recommendations

Parties to a secured transaction attempt to avoid these high costs and do not register their transactions. This practice promotes hidden transactions and creates secret liens. To encourage parties to register, a reforms should reward, not penalize, parties for notifying third parties of a secured transaction. Instead of taxing registration, low fees should be established to encourage registration and thus transparency and certainty to local credit transactions.

Registration fees should be calculated solely on the operational expense incurred by the registry office in receiving, processing and storing the recorded information. In addition, consideration should also be given to the operational and improvement needs of the registry when establishing fees.

M. Scope of the Registry System

Latin American secured financing systems are permeated with security mechanisms (statutory devices employed to secure a loan), quasi-security mechanisms (devices created by practice, not law, to secure a loan) and registration of mechanisms which would otherwise create secret liens (devices not considered security interests but which create a similar legal effect). The primary objective of a registry system is to provide notice to third parties that another person's goods may be serving as collateral for a loan. Consequently, the registry system must include all types of mechanisms if such mechanisms encumber one person's assets (debtor) in favor of another (secured party) to secure a loan.

The registry system should also register non-secured transactions, if such transactions involve the separation of possession and ownership of property. Such transactions include consignments in which the owner of goods delivers possession of them to an agent who places the goods on sale. The lease of personal property likewise requires that the owner/lessor transfer possession of the goods to the possessor/lessee in return for a fee.

A factoring, or sale of accounts receivable must also be included within the records of a registry system. Although factoring involves a sale between two parties, and does not constitute a loan, there is very little difference between factoring, or the sale of accounts receivable, and the taking of a security interest in such accounts. This is especially true if the sale allows recourse against the seller. With respect to factoring, it is also difficult to distinguish a sale from security interests because accounts do not have a physical manifestation that allows determining which party has possession of the goods.

Notice to third parties is particularly important with respect to transactions that involve a separation of possession from ownership, because the person (non-owner) in possession of the goods may attempt to sell or encumber the property without disclosing his actual rights in the property. (Financial leases, consignment agreements and conditional sales are typical examples of this type of transaction.) Consequently, even though such transactions are not

secured transactions, in order to ensure full protection of third parties, a registry system should require that these types of transactions be registered.

N. Computerized Registry Systems

Technology can play a prominent role in making the registration process more effective by improving how registrations are made, searched, and retrieved. Electronic registration is faster than traditional manual method and can be made from remote locations including private offices. The process can be fully automated and completed almost instantaneously. Under an electronic system, filings are not only recorded faster, but are also accessed faster than under existing methods.

Simplifying the process also makes filing less expensive to prepare, send, and have recorded. This is especially true with respect to the qualification process. An electronic system also increases the accuracy and security of filings by integrating templates and error correction programs. A computerized registry promotes uniformity in filing procedures and facilitates multiple jurisdiction filings. Electronic registries also solve the issue of the place of registration. Centralized electronic commercial registries make filings and searches throughout the country possible from a single location. The net effect of an electronic registry is greater speed, reduced costs, increased accuracy, uniformity, coordination between registries, and broader range of filings.