

THE REGISTRY: ESSENTIAL ELEMENT IN SECURED TRANSACTIONS

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I. Introduction:

This article addresses the role, functions and qualities of a public registry in secured financing systems, as discussed at the meeting of experts of the Organization of American States in Miami, Florida, on November 27-30, 2000. The article is not the usual legal publication with scores of footnotes citing legal precedents and references. It consists instead of the observations and conclusions of a practitioner in registry systems with 25 years of experience in different capacities. The article is based on experience in operating a registry, in assisting many countries with registry development and in defining the design requirements for registry technology systems. It is important to those who would develop secured financing systems in countries that do not have them, because the registry is the most critical and, at the same time, overlooked component of a successful secured financing structure.

II. Mission of the Registry:

The fundamental consideration in designing, developing and operating a registry is the purpose or mission of the registry in the secured financing regime. The mission must control decisions about the scope, structure and operational qualities of the registry. Where other factors conflict or interfere with the accomplishment of the true registry mission, they must be eliminated. With that said, what is the true mission of the registry?

The fundamental mission of the registry is to receive, maintain and disseminate information to (a) enable financiers to make informed business decisions and (b) perfect the non-possessory interests of financiers against subsequent creditors and the threat of bankruptcy of the debtor. The registry is concerned exclusively with providing notice of the existence of a relationship between a secured party (financier) and a debtor, as it relates to particular movable collateral. The notice is sufficient to alert potential future financiers to the existence of encumbrances, and to provide information on where to find more specific information on those encumbrances. The underlying rationale is reduction of lending risk by assuring financiers of repayment. The end result is to make credit available to businesses at lower interest rates, thereby enabling new business creation. In the end, the registry will give secured parties confidence in the system, and will result in increased business activity and vast improvement of the economic condition of the country as a whole.

It is also important to keep in mind what the registry's mission is not. First and foremost, the registry does not regulate the conduct of the parties to a financing transaction, nor is it concerned with assuring the legal effectiveness of the agreement between the parties. Therefore, there is no concern with the origination of the obligation, the terms of the transaction, the amount of the obligation, nor enforcement of the obligation upon default. Second, the registry's mission is not to raise revenue for the general funding of the government from fees or taxes on secured transactions. Gains in revenue to the government will come, however, from increased economic activity that is enabled by an effective secured financing regime that includes an efficient and effective registry.

III. Qualities of the Registry and How to Include Them in Structure:

With the mission of the registry as a starting point, it is necessary to define the qualities that a registry must have, and then to build those qualities into the structure of the registry. What follows is an enumeration of those qualities, with explanations of how they may be achieved.

A. Completeness:

The registry must include notice all non-possessory interests that may encumber movable collateral to the disadvantage of a potential financier. That is, the registry must include notice of any interest in collateral that may defeat a later perfected security interest in the same collateral. Registry reform must, therefore, provide for consolidation of any special registries for registration of interests in movables into one general registry for all non-possessory interests.

B. Jurisdiction-wide:

It must be clear to all users of the registry where to look for non-possessory interests in movables. Therefore, the registry must include all such interests for the entire jurisdiction in one central registry. The registry may have multiple entry points, but all must connect to and populate the same central database. For example, the central government may operate the registry, but provide for access for filing and searching through local government offices or through private remote intake points. A search done through a remote access point must reflect all relevant notices in the entire database. The use of remote access points is common in many existing electronic registry systems in North America, and such systems can be built using common technologies.

C. Priority assurance:

A person who files a notice of a security interest in the registry must be able to rely on the time of filing of the notice to determine his priority relative to competing interests. The registry must, then, have a method of affixing the time of receipt to notices, and priority among competing security interests must be determined by that time. That is, the first to file a notice in the registry has the first right to the collateral in the event of default on the secured obligation.

D. Reliability and Accuracy:

A user of the registry must be able to rely on the quality of the information provided, because it forms the basis for decisions that put assets at risk. The information must be captured accurately, and it must be maintained and reported reliably. Accuracy in the registry pertains to exact capture in the database of information transmitted by the filing party, not to accuracy of the intent of the filing party. When a notice that is filed on paper or by fax must be entered into the database by the registry, there are several technology safeguards that can insure accurate capture. Those include filling data fields from tables of recurrent variables rather than keying, and the use of system edits on data fields to insure that data are valid or possible values and are the right kind of data, i.e. alpha, numeric or alphanumeric. They may also include designing double blind data entry procedures in the software; that is, the system requires two persons to independently enter the most critical data fields such as the name of the debtor, which the system accepts only if there is an exact match between the two entries. But the most certain aid to accuracy is electronic filing of the notices directly from the filing party to the database, without human intervention in the registry. In that case, the data that populate the database are exactly as entered by the filing party, and the system immediately generates a notice to the filing party with the data that were

entered into the database. The filing party can then guarantee that the data were properly captured in the database. Electronic access eliminates keying errors by the registry and clearly places the burden of accuracy fully on the filing party, who is ultimately responsible.

E. Relevance and Simplicity:

The registry must include information that will permit a searcher of the registry records to determine (a) whether the collateral of the debtor in which the searching party is interested may be subject to a security interest, and (b) where detailed information about the security interest may be obtained. A notice in the registry needs no more than that. Therefore, notices should include only relevant information. Specifically, that information is: (a) clear identification and location of the debtor; (b) identification and location of the secured party or other person from whom the searching party can obtain information about the security interest; and (c) a sufficient description of the collateral subject to the security interest to permit the searching party to determine whether the collateral of concern may be subject to the prior interest. A simple, formatted notice such as the financing statement used in Canada and the United States satisfies the need and makes the relevant information easy to identify and capture in the database.

Capture of only the three elements detailed above implicitly reduces the review of documents to a matter of determining whether those elements have been provided. The corollary principle is that the registry makes only determinations of sufficiency for filing; it does not determine legal sufficiency of the underlying agreement.

Because the notice is only of the relationship between the parties, it does not create or diminish actual rights under the security agreement between the parties. Therefore, the degree of authentication of the identity and intent of the filing party is not as critical as if an actual agreement or instrument of conveyance were filed. This distinction makes it possible either to eliminate the traditional requirement for a signature on the notice, as Canada and the United States have done, or to permit other means of authentication such as electronic signature or symbol on an electronically transmitted notice.

When information requirements are reduced to only relevant elements with no requirement for legal review, it is possible to design a system that permits both electronic filing and electronic searching, because no human judgment and, therefore, no human intervention need be applied by the registry. Electronic intake can be designed with automated edits to determine whether filing requirements have been satisfied. Searching can also be automated, because search rules are non-discretionary. That is, the rules for selection of notices that match the search criterion use fixed logic to identify all notices that match the criterion, rather than to produce a list from which a registry official makes selections based on subjective judgments. Use of such fixed selection rules provides all users a degree of certainty that cannot be achieved with discretionary rules, provided that the fixed rules are known to the users of registry services.

F. Responsiveness:

The registry must permit a filing party to immediately file its notice and to receive an immediate acknowledgment of entry of the notice into the registry database. Conversely, the registry must provide for rapid access to information in the database by a searching party. There are many tools that the registry may use to achieve the rapid response that is required. They include data entry aids in the technology system such as auto-fill of fields, repeat functions and automatic opening of relevant fields. However, the greatest potential for speed of both entry of notices into the system and retrieval of information by searching parties is provided by electronic

filing and searching technologies. Many modern registries are designed to provide for such electronic access by private users, either directly or through remote access points provided by the registry or third party providers.

G. Openness:

Information is useful only if all who need it for business decisions can have ready access to it. The registry must, then, be available to all potential users without unnecessary restrictions. A small finance company in the remotest part of the country has just as much need of information as the largest bank in the nation's capital. Users should not be required by the registry to demonstrate that they have a need for access or that they are in a particular class of business, e.g. banking. Access must be convenient throughout the country without bureaucratic barriers and in a variety of media. If electronic access to the registry is provided, it must not be reserved to only those who have large financial resources. That is, there must be access points through which small users may file or search at costs comparable to those of large financiers. Those access points can be provided in a wide variety of ways. They may, for example, be provided by private sector companies who have the technology to connect directly to the registry database. In such cases, the companies would have to meet the technology requirements of the registry, and would compete with each other for the business of the end users. The access points may also be provided by the government through local government offices or kiosks operated by the registry.

H. Debtor Identification by True Name:

The principal key data element that is used for access to information in the database is the name of the debtor. The need for accuracy of the debtor's name is paramount, because an error either in the notice filed in the registry or in the search criterion entered by a searching party will cause the notice to be overlooked in a search. This requires that the burden for insuring correctness of the debtor name be placed on the filing party and on the searching party. The registry should not be placed in the position of determining whether a name in the database identifies the same debtor as does a similar name entered on a search request. There should, therefore, be a clear burden placed on filing parties and searching parties to get the debtor name exactly correct. In the case of individuals, that means filing parties and searching parties must check an official identification document of the individual. In the case of entities, it means that they must check the official records of the registry in which the formation document of an entity is filed.

The use of true debtor names permits the registry to employ search technologies to insure that all notices that identify a particular debtor are identified and retrieved in a search of the database where both the name in the database and the search criterion name are correct. Those technologies are available and in use in many jurisdictions, and are easily transferable to new registries. In general, the search logic used in such systems generally requires identification of debtors as either individuals or business entities, because the techniques for searching for individual names and for entity names are substantially different. Therefore, the procedure for intake of information into the registry archive should compel filing parties to distinguish debtors on that basis.

I. Use of Unique Identifiers of Registry Documents:

Each document that is filed in the registry must be identified by a unique number so that it may be maintained and retrieved with certainty. Unique identifiers are also required to permit a filing party to file later documents that relate to an original notice, e.g. to file amendments. The

filing party must be able to positively identify the original notice document to which a later filing relates. The best way to identify documents is by a unique number assigned to each document by the registry. Use of unique numerical identifiers permits technology systems to link related documents so that a search will produce a meaningful report.

In order to insure that an amending document correctly identifies an original filing document to which it relates, the registry should include in its numbering scheme the use of authentication digits that permit the registry technology to detect errors in the identifying number of the original filing that is entered by the filing party of the amending document. This implies that the technology system used by the registry must assign the identifying numbers and be able to instantly perform the computations necessary to validate any existing number that is entered into the system. Use of authentication digits will permit the degree of certainty in identification of documents that will permit electronic filing of amending documents to existing records.

J. Use of Different Searchable Data Elements:

The principal criterion for searching the archive for a notice of a security relationship is, of course, the name of the debtor. However, the law of the jurisdiction may also permit searching of the archive for particular high-value items of collateral that are identified by serial number, i.e. end items such as vehicles and large industrial machinery. In that case, the archive must permit entry of and search on serial numbers within identified classes of collateral. For example, if the jurisdiction's law provides that notices of security interests in motor vehicles must be retrievable by vehicle identification number (VIN), there would be a class for motor vehicles, and within that class, the VIN would be the search criterion. In addition to debtor name and serial number of end items, any notice must be retrievable by its unique numeric identifier. The laws of some jurisdictions may further require that notices be retrievable by the secured party name.

K. Hierarchical Archive Structure:

The most effective way to incorporate the foregoing qualities into the archive is to organize the archive in a logical manner. The structure that is used in most existing registry systems is a hierarchical structure for both the data elements in a notice and all documents related to an original notice.

As to the data elements in a notice, the basic unit in the archive is the notice document that provides information on the relationship of one or more debtors, one or more secured parties and the collateral that is subject to the security interest. However, each notice record includes subordinate records for at least each debtor and each secured party. There may also be a subordinate record for the collateral if the system provides for searching on serial numbered end items, or if the archive includes electronically filed notices.

As to related documents, the original notice is the base of the file, and each amendment or other document that affects the original notice is a subordinate record in the file. Each subordinate record is related to the original notice by the original notice's unique numeric identifier.

L. Provision for Termination of a Notice and Self-clearing Archive:

Since the purpose of the notices that are filed in the archive is to give notice of the relationship between a debtor and a secured party with respect to identified collateral, the archive should either be cleared of the notice or at least include an indication of the termination of the

relationship, once the relationship ends. That is, when there is no further debt and no obligation on the secured party to make further advances of credit under the agreement, the notice should be terminated. Whether that takes the form of removing the notice from the active archive or addition to the archive of a notice of the termination of the relationship, it is important that the record be cleared in order to permit the debtor to obtain future credit secured by the same collateral.

In the event that a notice of termination of the relationship is not filed in the archive, the law should provide for a limited life of notices in the archive. After the prescribed period, notices should automatically be removed from the active archive by the technology system. If a security interest lasts longer than the prescribed period, it should be a simple matter to file an amending document to continue or extend the notice's life.

M. Minimum Transaction Cost to User:

The jurisdiction and the registry operator must adhere to the fundamental rationale for the registry, i.e. to enable business decisions and thereby to increase business activity and improve the economic condition of the nation. Therefore, there should be as little burden on use of the registry as possible. One burden that is most easily limited is the transactional cost of the registry to its users. The transactional cost to users must reflect the cost of operation of the registry. Therefore, the registry operator must determine the actual gross cost of operation and the volume of notices filed in the registry, so that the appropriate fee structure can be developed. Cost of operation bears a relationship to the number of transactions, but there is no relationship to the amount of the secured transaction for which the notice is filed. Therefore, the basis of fees should be a flat fee per notice, and not a percentage of the amount of the transaction. For that matter, there should be nothing about the amount of the transaction in the notice, as it is not relevant to the purpose of the notice.

IV. Conclusions:

One recurrent theme in the foregoing discussion of registry qualities is their relationship to the use of an electronic archive and electronic communication media for filing of notices and searching the archive. If a registry embodies the qualities, electronic communication of notices is made feasible. Conversely, if notices are communicated to the registry electronically, it is much more likely that the registry will embody many of the qualities. Therefore, those who write the secured financing law and those who design the registry must consider the desired qualities and the adoption of electronic archive and communication media in one piece.

The other, and most important, recurrent theme is that the operation and structure of a registry must be guided by its mission. If a registry embodies the qualities set out in this paper, it will enable secured financing transactions with the minimum possible burden on the users of the registry. When the scope of the registry's operations is limited to what is required to accomplish the mission, it will work most effectively. There are many ways to get it wrong by requiring the registry to do too much, but it is easy to get it right if the mission is the guiding principal.