The key legal elements of asset-based lending from the perspective of UNCITRAL

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12. Summary
1. The overall objective of the ABL regime

- To promote the availability and decrease the cost of credit
  - By reducing the risk of debtor default and insolvency

- Limitations:
  - No law can on its own have an automatic economic effect
  - Other conditions: a modern and efficient enforcement infrastructure, registry, and coordination with insolvency and property law

- Disclaimer:
  - The current crisis is to a large extent due to the violation of the principles of ABL (e.g. asset valuation and monitoring by the secured creditor), and the lack of supervision by regulatory authorities
2. **The functional, integrated and comprehensive approach**

- A regime composed of various laws addressing different aspects of secured transactions and ABL is bound to result in gaps and inconsistencies

- The functional, integrated and comprehensive approach (based on the principle of “substance over form”) results in:
  - Comprehensive coverage of all devices serving security purposes, including transfers of title for security, ROT sales and fin. leases
  - Competition of credit providers, which is likely to have a beneficial impact on the availability and the cost of credit
  - Harmonization: cross-border recognition of security devices, which is likely to facilitate international trade financing
3. Simple and efficient creation of SIs

- Simple creation: by agreement and, in the case of possessory SIs delivery
  - If there is delivery, oral agreement is enough
  - If there is no delivery, written agreement is required, but with flexible form requirements (e-form and signature)
  - Agreement has to identify the parties and describe the secured obligation and the encumbered assets

- Security in future assets to secure future obligations
  - Need to protect borrowers from excessive economic commitment, while avoiding to protect them to … death, depriving SME’s of the only credit available to them, secured credit, often based on future assets
4. Third-party effectiveness

- Third-party effectiveness and priority methods
  - general registration
  - Specialized registration or title certificate system
  - Possession
  - Control

- Results:
  - Creation is not complicated by unnecessary formalities
  - Form-free transactions (ROT sales) may be covered
  - Time- and cost efficient registration
  - Transparency as to the existence of SIs
  - Objective method for determining priority
5. Efficient registration system

- Notice, not document registration

- Minimum content of notice: publicity and confidentiality combined

- Legal consequence: third-party effectiveness and basis for priority, not creation

- Electronic registry: time- and cost-efficiency

- Certainty with ST law, practicality and flexibility with registry regulations
6. Comprehensive and efficient priority rules

- Ability of borrower to use the full value of its assets as collateral raises the issue of priority (who gets paid first)
  - But, if there is no certainty as to the priority, no secured creditor is likely to be willing to lend or will lend at a cost

- General priority rule:
  - First in time of advance registration (registration before creation of SI) or third-party effectiveness (creation and registration)

- Exceptions:
  - Possession of NIs or ND beats registration
  - Control of B/As and L/Cs beats registration
  - Specialized registration beats general registration
  - Acquisition SI beats ordinary SI
  - Supplier acquisition SI beats bank acquisition SI
  - OCOB transactions
7. Efficient enforcement mechanism

- If enforcement takes too much time or cost, SCs are likely not to lend or lend less, at higher interest rates and/or shorter repayment periods

- Judicial enforcement subject to general civil procedure law
  - Protection of SC: expedited procedures

- Extra-judicial enforcement subject to ST law
  - Protection of debtor in the case of extra-judicial repossession of collateral (consent, notice and absence of objection during repossession)
  - Extra-judicial sale of collateral: good faith, reasonable commercial standards
  - Distribution of proceeds: unsecured claim for shortfall and return of surplus
  - Finality of rights: acquisition free of SI of enforcing SC and junior SIs
8. Coordination with other law (quasi security devices)

- ROT sales, fin. leases, acquisition SIs: subject to registration
  - Result: no more hidden SIs, level playing field that should encourage competition and drive down cost

- Still, policy of favouring suppliers of goods on credit can be pursued by giving priority to acquisition over non-acquisition SI and to supplier over bank credit

- Importance and priority of acquisition financing
  - Acquisition SC helps enrich the borrower's estate
  - Acquisition SC has priority but only if subject to registration within a short period of time after delivery of the goods
  - Priority of an acquisition security right extends to proceeds with the exception of cash proceeds of inventory

- Unitary v. non-unitary approach in the case of enforcement
9. **Certainty as to the law applicable**

- Importance of applicable law in int’l ST: scope of application of substantive law, determination of the country in which registration must take place, cross-border recognition of SIs

- Matters covered: creation, third-party effectiveness and priority of a security right (in most cases subjected to the same law)

  - *Lex rei sitae* for security rights in tangibles
    - Law of the grantor’s location for mobile goods
    - Exception: law of the State of the registry for goods subject to specialized registration
    - Special rule for goods in transit and export goods

  - Law of the grantor’s location for intangibles
    - Exceptions: intangibles subject to specialized registration, B/As, L/Cs, IP, NIS

- Separate rule for mutual rights and obligations of the parties
  - Law chosen by the parties and, in the absence of a choice, law governing the security agreement

- Separate rule for enforcement
  - General tangible assets: *lex rei sitae*
  - General intangible assets: law governing priority
10. Coordination with property law

- With banking law, if the asset is a B/A
- With L/C law if the collateral is an L/C
- With NI and ND law, if the collateral is a NI or a ND
- With IP law, if the collateral is IP
- With NIS law, if the collateral is NIS
11. Coordination with insolvency law

- Encumbered assets are part of the estate (subject to stays)
  - Liquidation v. reorganization and relief for secured creditor: protection of the value of the assets, monthly payments, additional security

- Effectiveness of SI respected, subject to avoidance of preferential or fraudulent transfers within the suspect period

- Priority of SI preserved, subject to preferential claims
  - Limit preferential claims and state them clearly in the law

- In re-organization, SCs may be forced to accept the plan but must be protected and receive as much as in liquidation

- Post-commencement financing: no priority unless ordered by the insolvency court subject to protection of SIs
12. Summary

- The overall objective of a modern and efficient ST law
- The functional, integrated and comprehensive approach
- Simple and efficient creation of SIs
- Third-party effectiveness and priority
- Efficient registration system
- Comprehensive and efficient priority rules
- Efficient enforcement mechanism
- Coordination with other law (quasi security devices)
- Certainty as to the law applicable law
- Coordination with property law
- Coordination with insolvency law
• Thank you!

• The views expressed are the personal views of the author and do no necessarily reflect the views of the United Nations or UNCITRAL.

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