

Explanatory notes for the regional survey tables

Details on the questions in the survey and the methods used in completing each of the five tables in each country survey:

Understanding the tables

It is expected that most secured transactions systems will score well in **table 1**, which aims to list the essential elements that are required for a secured transactions law to operate. Any downgrade reflects a potentially serious deficiency. The following tables concentrate on specific aspects of the charge and amplify the answers given in this first table. **Tables 2, 3 and 4** give an indication of the extent to which the law and practice allow the charge to be used in a way which responds to the needs of a market economy. **Table 5** assesses the robustness of the charge as a remedy for payment default by the debtor. The picture that can be drawn from these tables should thus give some measure of the economic benefit that the credit market in a country can expect to derive from its collateral laws in their present form. It also indicates the areas that have to be addressed if that benefit is to be increased.

The survey covers consensual charges over movable property (including intangibles). It is limited to transactions which create a proprietary, non possessory charge, that gives the debtor the right to remain in possession of the assets during the life of the charge and the creditor the right to recover a claim by having the charged assets realised and the proceeds used to satisfy the secured debt. It does not cover other transactions which may have a similar economic effect, such as possessory charges, financial leases, retention of title, fiduciary transfers, warehouse receipts, assignments of receivables or factoring arrangements, although mention of them is sometimes made when relevant. It also does not cover immovables or special regimes applicable to particular types of asset such as vehicles, ships, aircraft and securities, or particular types of charge such as enterprise charge. Security arising by operation of law or created by court or administrative act is not included but may be mentioned when relevant to the priority ranking of the secured creditors.

Where the legal or practical position is complex, the answers can only give an initial indication. The EBRD Core Principles for a Secured Transactions Law serve as the basis for the criteria used to decide grades. In cases where there is doubt, a cautious rating is applied. The questions have been framed to achieve a meaningful assessment of the practical and economic effectiveness of the legal framework on charges, rather than being limited to those areas where a grade can easily be given.

Key to the grading system

The grading system reflects a gradual assessment from a clear yes (✓✓✓) to a clear no (×××):

Key	
✓✓✓	Yes
✓✓	Yes, but with some reservations
××	No, but there are some mitigating factors in law or practice
×××	Categorical no
?	Uncertain

Table 1: Key elements of a charge

1.1. Does the charge create a proprietary security right?

Security for debts may be either personal, such as a guarantee which gives a right to make a personal claim against the guarantor, or proprietary, such as a charge which gives a right to have the charged property sold to satisfy the claim. This survey is limited to proprietary security and the first question assesses the extent to which the charge really is proprietary in nature. The concept of proprietary right may vary from one jurisdiction to the next but the principal factors taken into account are (i) the ability of the chargeholder to enforce his or her claim ultimately by requiring the charged property to be sold so that the proceeds can be used to satisfy the secured debt, and (ii) the extent to which the rights under the charge are valid against third parties claiming a right in the charged assets.

Formal classification is not necessarily compelling. For example, under the Russian Civil Code security rights are classified as personal rights and this has influenced other CIS countries. Notwithstanding that classification, charges in Russia are essentially proprietary in nature and therefore a rating of ✓✓✓ is given.

1.2. Can the charge be granted by any person?

In some countries, the law allows charges to be created only by commercial entities or merchants. Such an approach may have been selected due to the lack of consumer protection laws.

It is assumed in the grading that the person has a right over the property charged (he cannot create a charge over another person's assets) and has legal authority or capacity to grant a charge (e.g. he is not a minor or mentally incapacitated).

1.3. Can the charge be granted to any person?

There can be some restrictions as to who can receive benefit of a charge, for example if they are not professional lenders. As this restricts availability of security to others that may advance funds (e.g. a supplier to his customer or inter-company credit), a lower grade is given. It is assumed that the person has legal authority or capacity to receive a charge.

1.4. Can the charge secure any debt?

The grade given relates both to the type of debts and to the form of debts (fluctuating debts, debts described generally) which can be secured. It does not relate to restrictions on the person who can be chargor or chargeholder which are noted under questions 2 and 3 in this table.

The question assumes that the debt is defined or definable in monetary terms.

Where a downgrade is given on any of questions 5-8 of table 3 (general definition of secured debt, future debt, foreign currency or fluctuating pool of debt) the grade ✓✓ is given here.

1.5. Can the charge cover all types of asset?

The scope of the present analysis is confined to security over movables (including intangibles); it does not extend to land and other immovable assets.

The grade given relates both to the type of assets that can be charged (e.g. movables, claims and other rights) and to the form in which they can be charged (e.g. fluctuating pools of assets, future property, and assets described generally).

Where a downgrade is given on any of questions 2-4 of table 3 (general description of charged property, after-acquired property, fluctuating pool of assets) the grade ✓✓ is given here.

Enterprise charges are not covered in this survey.

Some prohibitions on security commonly found in legislation which can be reasonably justified have been ignored for the purpose of giving a grade:

- Property which cannot be transferred, often referred to as property removed from civil circulation, for example historic or artistic treasures. Where the categories of property concerned go beyond what would normally be expected, or wide powers exist to exclude property from civil circulation, this is noted.
- Property of physical persons which is deemed a minimum necessity of life, for example essential personal effects and an individual's basic tools of trade.
- Claims which are of a strictly personal nature, for example claims for wages or alimony.

1.6. Does the charge give priority over all other creditors?

This question covers priority of the charge both before and after bankruptcy / insolvency of the chargor, and thus effectively encapsulates the response to questions 1 and 2 of table 4.

Table 2: Creation of the charge

This section relates solely to charges created by agreement between the parties and excludes any consideration of the creation of charges by operation of law or by judicial or administrative order. A charge is treated as created when it is valid as against third parties generally. When the law makes a distinction between 'attachment' and 'perfection', the questions treat the creation process as being attachment plus perfection.

2.1. Is the manner of creating a charge clearly defined?

In some CIS countries, debts that require notarisation in order to be valid can only be secured by charges which are also notarised. Although some uncertainty exists as to which debts have to be notarised no downgrade is given for this.

2.2. Is the manner of creation of charge simple?

The most frequent problems relate to inefficient and/or unnecessary administrative requirements (for example production of documents or checking of information) especially for registration.

2.3. Is the manner of creation of charge quick?

The grade given is based on the time that creation is likely to take for a simple charge transaction:

✓✓✓	Within one day
✓✓	Two to three working days
xx	Four to five working days
xxx	Over five working days

Most delays arise from problems concerning registration.

2.4. Are charges publicised through registration?

The security right gained by a chargeholder is a right in rem and attaches to the property encumbered. For a proprietary security to be effective it is important that any person dealing with the charged property is able to find out about the chargeholder's right in the secured assets. The grading does not take account of registration in asset registers such as for shares and vehicles.

Effectiveness of the system is dealt with in question 4.3 ('can a third party determine whether property is charged?').

Some countries provide for a voluntary system of tagging to identify the charged property. Although this can be helpful in some circumstances it is not considered to be a proper system of publicity.

In some CIS countries companies are required to keep a charge record book. This is noted where relevant but is not treated as effective publicity as there is little evidence of the system operating satisfactorily.

When charges are taken on receivables, notice to the debtor of the existence of the charge is not deemed to provide publicity since it does not enable third parties to find out about the existence of the charge.

When securities and cash are used as collateral normal requirements for publicity through registration may not apply as a result of the Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements.

2.5. Are costs of creation low enough not to dissuade?

Costs of creating a charge may arise both from specific costs (notarisation and registration fees or taxes) and through legal fees and other expenses which are linked to the complexity of the creation procedure. The level of costs which are likely to dissuade depends on the context (a 1.5% fee may not be dissuasive for a farmer purchasing a piece of machinery worth €1,000, whereas it would be on a multi-million euro project). On the contrary, a €100 fee would be easily absorbed in the costs of a large transaction, whereas it would represent a dissuasive cost in the context of micro or SME finance. Account has been taken of the threshold minimum fee levels, and, where percentage rates are used, both the actual percentage rate and the extent to which it reduces on higher amounts

Table 3: Commercial effectiveness

The questions in this table are designed to assess the extent to which the legal framework and the way it is applied in practice are adapted to the needs of commercial transactions in modern market economies.

3.1. Can the chargor use charged property?

Legislation can sometimes place restrictions upon the manner in which the charged property may be used. Rules which prevent the chargor from making proper economic use of the property during the life of the security right will be indicated in a lower grade.

The right to use includes the right to 'consume'. Consumption can be in various forms:

- (i) Consumption which leads to the charged asset ceasing to exist (e.g. fuel). This is often not covered expressly in the law. However it is assumed that if, for example, a debtor gives a charge over a fluctuating stock of fuel that he uses to run his factory, the parties must have intended that he could continue to use fuel. A downgrade is only given where the charge would prevent such continued use. The effects of any requirement to replace with substitute collateral is dealt with under question 3.4 (fluctuating pools).
- (ii) Consumption which leads to the charged asset being transformed/incorporated into other assets (e.g. raw materials used in manufacturing process). The position is similar to (i). In some jurisdictions the transformed or incorporated asset continues to be subject to the charge but this is not relevant to the grade.
- (iii) Consumption of inventory (i.e. sale to customers) - this is covered under question 4.4 (sales in the ordinary course of business) and thus any

restrictions on the right to sell to customers does not lead to a downgrade here.

3.2. Can property be described generally?

The description of the charged assets has to be adequate to enable their identification but problems are often encountered in practice due to an obligation of specificity which leads to onerous procedures for describing the charged assets. Where a general description of the charged property is allowed only for goods in circulation and processing a grade of **xx** is given.

3.3. Can a charge be given over after-acquired property?

Although many laws provide for the charging of future property, the time of creation of the charge as a proprietary right and its priority ranking are sometimes unclear. In these cases a grade of **✓✓** is given.

3.4. Can a charge cover fluctuating pool of assets?

In some CIS countries charges are permitted over fluctuating pools of assets which are 'commodities in circulation or processing'. This would, for example, cover inventory of raw materials or finished goods but not other types of property which may also be subject to constant change, such as equipment and machinery or accounts receivable. In this case the grade of **✓✓** is given. A legal requirement to substitute new assets for assets leaving the pool, or to maintain a minimum value of assets in the pool, may lead to a downgrade unless the legal requirement can be waived contractually.

3.5. Can the secured debt be defined generally?

Where there is an obligation of specific identification of the secured debt, which precludes or limits the ability to use a general description (for example, all amounts due to a supplier for goods supplied) this is noted and reflected in the grade.

3.6. Can a future debt be secured?

Many laws do not refer specifically to securing future debts. Where a law allows a wide range of debts to be secured it is assumed that it also allows for the securing of future debts, unless there is evidence to the contrary.

3.7. Can the debt be in a foreign currency?

If the question of securing foreign currency debts is not explicitly covered in the secured transactions law, the grading is given on the basis of established practice, even if no legal authority in support is available. A requirement to state the equivalent in local currency will lead to a downgrade if this may limit the ability of the creditor to recover the full foreign currency amount on enforcement. On the contrary, where the register or the charge document has to specify the amount in local currency solely for information purposes, the grade of **✓✓✓** is given.

Exchange control restrictions are not taken into account. The treatment of foreign currency claims under insolvency procedures is outside the scope of this survey.

3.8. Can a fluctuating pool of debt be secured?

An obligation of specification of the secured debt, or a restriction on future debts, which precludes or limits the ability to secure a fluctuating pool of debt (for example, amounts borrowed on overdraft facility, or becoming due on a trading account, where the amount outstanding may decrease or increase from day to day), is noted and reflected in the grade.

3.9. Do parties have wide flexibility to agree commercial terms?

This does not look at restrictions on the type of security instrument that has to be used, but at the ability of the parties to adapt the instruments that do exist to the needs of their particular transaction (for example, acceleration clauses, maintenance of charged assets, inspection rights). Restrictions on the right to agree the manner of realisation are covered under table 5 and not here.

3.10. Are subsequent charges permitted over same property?

Some countries recognise that an agreement by the chargor not to create further charges, often called a negative pledge, is effective against third parties who have notice of it. A downgrade is given where the use of such clauses in practice significantly limits the ability to create further charges.

Table 4: Effect of the security right on third parties

4.1. Does the charge give priority in the charged property?

The grade given in this question reflects the extent to which the principle of the chargeholder's priority is respected pre bankruptcy. It is considered normal for the costs of enforcement of the charge to rank ahead of the chargeholder's claim and this does not prevent a ✓✓✓ rating.

Claims for personal injury are often ranked ahead of secured claims in CIS countries. This does not prevent a ✓✓✓ rating.

Where priority is given, for example, for tax and/or social security claims, the rating depends both on the extent of the priority and on the means available in practice to exercise it on enforcement.

Statutory liens where, for example, priority is given to a repairer for the cost of repairs do not affect the grade.

The rights of an unpaid vendor under retention of title clause are also not taken into account, since the charge cannot take effect until the purchaser has title. Where priority is given to purchase money charges this is noted but the grade is not changed.

4.2. Does the secured creditor have priority in bankruptcy?

This question covers two issues:

- the continued existence of the security right in bankruptcy/insolvency; and
- the priority of the secured creditor in the proceeds of sale of the charged property (which may be different after bankruptcy/insolvency).

The costs of realising the charged property in insolvency will normally have priority over the claim of the chargeholder. However where other costs of the bankruptcy procedure take priority over a charge, a grade of ✓✓ is given.

Where a general priority on bankruptcy is given for wages claims and/or for tax and/or social security claims the rating is ✕✕, but this may be raised to ✓✓ if it is limited in scope, for example to 3 months' outstanding wages.

It must be recognised that in practice there will be cases where the costs of the bankruptcy procedure or 3 months' outstanding wages may absorb all the proceeds from charged property.

A charge may often be set aside under insolvency rules if it was granted too close to the time of bankruptcy. This is not covered under this question. Also provisions under insolvency laws, which provide for a moratorium on creditors' rights, including secured creditors, do not affect the rating.

4.3. Can a third party determine whether the property is charged?

This question is closely linked to question 2.4.

The question is aimed at the third party who wants to take a proprietary right in the property himself and therefore wants to be sure that no-one else has a right in it. It therefore seeks to assess whether the third party can in principle and in practice discover other charges that exist or may exist. If the description in the register does not give a meaningful description of the charged property this is reflected in the grade.

If it habitually takes more than three days to obtain the information a downgrade is given.

4.4. Does a third party acquire property free from charges in the ordinary course of business?

The ordinary course of business is not the only case in which third parties may habitually acquire the charged assets free of charge, but it is probably the most important for the proper functioning of the markets. The question aims at determining the extent to which a person who acquires an asset in the ordinary course of business is protected from the claims of a person who has a charge over the asset.

Where the ordinary course of business exception only exists for commodities in circulation or processing a ✕✕ rating is given.

4.5. Is person acquiring bona fide without notice of charge protected?

This question was originally included in the survey at a time when few countries had compulsory registration systems. A country where registration is required and where

the effect of registration is to put third parties on notice of the charge is given ✓✓✓. The question does not seek to cover the relatively rare case where, following successive transfers, the charge is not registered against the name of the new owner.

Table 5: Enforcement of the charge

The manner in which the security right can be exercised will be influential in determining the value of the charge. A law, which has achieved high grades in the previous tables, may give little economic benefit to a country if the procedures and practice for enforcement of the charge are not effective. The questions seek to establish the position that exists in practice, not just on a strict reading of the law, although inevitably the practice on enforcement takes time to develop and it is difficult to give consistently precise answers.

5.1. Is the manner of enforcement of the charge clearly defined?

Enforcement may be covered by separate legislation on civil and commercial procedure. For some jurisdictions it is difficult to determine with certainty which provisions apply and how those that do apply should be interpreted. Also, if secondary legislation has not been adopted, the market may feel unsure about using enforcement.

5.2. Is there tried practice?

Where the law is new or has recently been amended a downgrade may be given until practice under the new provisions is established.

5.3. Can the chargeholder protect assets?

One of the classic problems met by a creditor who accepts non-possessory security is to find that the charged assets have disappeared by the time he is able to enforce. The resulting claim for damages may be of little comfort. This question aims to assess the extent to which the creditor is able to take pre-emptive action to prevent this happening. Issues taken into account in determining the rating include the right of the secured creditor to take possession, his ability to enforce that right, alternative methods of protection where possession is not feasible, and the incentive on the chargor to comply.

5.4. Can the chargeholder obtain rapid realisation?

Grades are based on the estimated length of the process necessary for successful enforcement, from the commencement of enforcement procedure to collection of the proceeds of sale.

✓✓✓	Up to three months
✓✓	Between 2 and 6 months
xx	Between 6 and 12 months
xxx	Over 12 months

The type of enforcement (court driven or out-side court) the most commonly used serves as yardstick.

5.5. Can the chargeholder exercise control on the way realisation takes place?

This question seeks to cover both the nature of the sale and the manner in which it is controlled:

- Is there a compulsory procedure for public auction or can the chargeholder be given flexibility to organise the sale in other ways?
- How closely is the sale procedure controlled by the court?

The question is included as these issues can often be critical in determining a law's efficacy, but it is recognised that the optimum sale regime has to be determined by the circumstances of each jurisdiction and is ultimately tested by the result (see questions 4 and 6).

Where the chargor's consent to a private sale is required after enforcement has commenced this is graded **xx** since a chargeholder cannot rely on obtaining consent at this stage.

5.6. Does the enforcement procedure allow expectation of reasonable realisation proceeds after costs?

The grades are principally based on estimates by local practitioners of the likely return on the realisation of charged assets minus the enforcement costs. They also take into account the complexity of the enforcement process.

This question looks at enforcement procedures but does not take into account the effect of insolvency.

5.7. Does commencement of enforcement have to be publicised?

A third party dealing with the chargor may want to know not only whether a charge has been given, but also whether it is being enforced. This information can most easily be made available through a registration requirement.

The requirement to advertise a public auction of charged property is not counted for this purpose as the auction may happen a long time after enforcement has commenced.

5.8. Is the purchaser in enforcement procedure protected?

One of the factors that may make satisfactory realisation more difficult, particularly in the case of private sales, is the concern of prospective purchasers that other parties may be able to attack the sale and/or claim competing rights in the sold assets. Where protection is only given where the sale is at public auction a **✓✓** grade is given.