



Core principles for a secured transactions law

Since the publication of the EBRD Model Law in 1994 there has been a continuing programme of reform of security laws in the Bank's countries of operations.

During the country-specific work of the Bank's Legal Transition Team it became evident that the Model Law is an important and helpful instrument for local reformers. However, it became clear that a more general formulation of the goals and principles of successful reform to foster economic development would be useful. This has led the EBRD to define a set of 10 core principles for a modern secured transactions legislation. These principles form the basis for assessing a country's secured transactions law and for identifying the need for reform.

The principles are drawn on the assumption that the role of a secured transactions law is economic. It is not needed as part of the essential legal infrastructure of a country: its only use is to provide the legal framework which enables a market for secured credit to operate.

The principles do not seek to impose any particular solution on a country - there may be many ways of arriving at a particular result - but they do seek to indicate the result that should be achieved. As with any set of general principles of this nature they must be read within the context of the law and practice of any particular country and they do not aim to be absolute; exceptions inevitably have to be made.

1. Security should reduce the risk of giving credit leading to an increased availability of credit on improved terms.

This goes to the basic assumption made by the EBRD on all its work on secured transactions law reform.

2. The law should enable the quick, cheap and simple creation of a proprietary security right without depriving the person giving the security of the use of his assets.

In most market economy scenarios depriving the debtor of the use of his assets is self-defeating; non-possessory security which gives a remedy attached to the charged asset is an essential element of a modern secured transactions law. Any delay, cost or complexity in the creation process reduces the economic efficiency of security.

3. If the secured debt is not paid the holder of security should be able to have the charged assets realised and to have the proceeds applied towards satisfaction of his claim prior to other creditors.

The exact nature of the proprietary right that arises when security is granted has to be defined in the context of the relevant laws. If it is to be effective it must link to the creditor's claim the remedy of recovering from the assets given as security.

4. Enforcement procedures should enable prompt realisation at market value of the assets given as security.

A remedy is only as good as the procedures and practice for exercising it allow it to be. If the value received on realisation is expected to be only half the market value, then the provider of credit will require more assets to be given as security. If it is expected that enforcement will take two years then the creditor will give less favourable credit terms to the debtor.

5. The security right should continue to be effective and enforceable after the bankruptcy or insolvency of the person who has given it.

The position against which the creditor most wants protection is the insolvency of the debtor. Any reduction of rights or dilution of priority upon insolvency will reduce the value of security. A limited exception to this principle may be necessary to make it compatible with rules which permit a moratorium at the commencement of insolvency.

6. The costs of taking, maintaining and enforcing security should be low.

A person granting credit will usually ensure that all costs connected with the credit are passed on to the debtor. High costs of security will be reflected in the price for credit and will diminish the efficiency of the credit market.

7. Security should be available (a) over all types of assets (b) to secure all types of debts and (c) between all types of person.

This principle covers a multitude of issues that may arise between the way law is applied and the needs of commercial reality. They may appear technical but can be of critical importance when seeking to implement a commercial agreement. With very limited exceptions (for example, personal clothing) a person should be able to give security over any of his assets, including assets he may acquire in the future. Similarly a charge should be capable of securing any type of present or future debt or claim that can be expressed in money terms.

The charged assets and the secured debt should be capable of general description (for example, all machines in a factory, all debts arising under sales contract). It should also be possible to charge constantly changing "pools" of assets such as inventory, debts receivable and stocks of equipment and to secure fluctuating debts such as the amount due under a bank overdraft facility. Any physical or legal person (whether in the public or private sector) who is permitted by law to transfer property should be able to grant security.

8. There should be an effective means of publicising the existence of security rights.

Where security is possessory the mere fact that the assets are held by the creditor is enough to alert third parties that the debtor has charged them. Where security is non-possessory some other means (normally a public registry or notification system) is needed to ensure that third parties do not acquire charged assets without being made aware of the existence of the charge.

9. The law should establish rules governing competing rights of persons holding security and other persons claiming rights in the assets given as security.

Even when an effective means of publicity is in place there remain some cases for which the law has to provide, for example sales of charged assets in the ordinary course of the owner's business (where the purchaser cannot be expected to inspect a register before purchasing).

10. As far as possible the parties should be able to adapt security to the needs of their particular transaction.

The law is there to facilitate the operation of the secured credit market and to ensure that necessary protections are in place to prevent debtor, creditor or third parties being unfairly prejudiced by secured transactions. It should not be the purpose of the law to create rules and structures for the operation of secured credit which are aimed principally at directing the manner in which parties to secured credit should structure their transaction.

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