

# Difficulties in Creating a Notice-filing System for Immovable Property

Professor Tom Johnson, Osgoode Hall Law School

EBRD

Secured Lending in Commercial Transactions:  
Trends and Perspectives

4–5 November 2013

# OVERVIEW

1. Suggestions for reform: notice instead of registration
2. Tier One Land Registration Transactions
  - i. Land / title registration systems
  - ii. Notice-filing systems for movable property
  - iii. Suitability of a notice-filing system for immovable property
3. Tier Two Land Registration Transactions
  - i. Covered Bonds and Mortgage Backed Securities
  - ii. Registration Issues – MERS and uncoupling
  - iii. Suitability of a notice-filing system for registering tier two transactions
4. Other Issues
  1. Access to land registration systems and the prevention of fraud
  2. Is technological innovation outpacing registration concepts?
  3. Land register / land titling reform
5. Conclusion

# Introduction

- Suggestions for mortgage registration reform
  - A single framework
  - Notice-filing system
- Is this feasible?
- Two tiers to a land registry system when dealing with mortgages
  - Tier One refers to the register of title
    - A mirror of the legal rights and obligations of the titleholder and encumbrancers
  - Tier Two refers to notice-filing systems for second level transactions that we encounter in covered bonds and mortgage-backed securities

# Tier One Land Registration Systems

- Cadastral system
  - Cadastral survey / map
  - Notaries
  - Public register of real rights
- Torrens system:
  - Cadastral survey
  - Each parcel in the survey map has a unique identifier, which is the reference for a unique folio (page) in the register
  - Each folio contains three elements
    - Property description
    - Title holder
    - Encumbrances

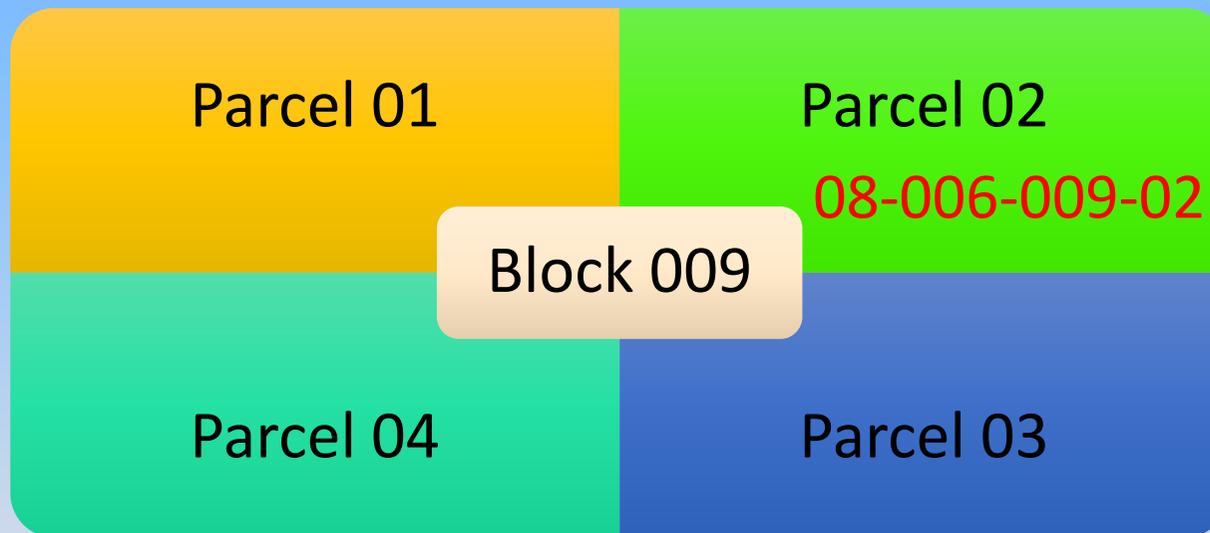
# Tier One Land Registration Systems

- The key principle of a Torrens system is that registration creates an indefeasible interest
  - i.e. the State usually guarantees the information recorded on two of three elements of the register
    - ownership and encumbrances
- The system works on three principles:
  - 1) Mirror principle
  - 2) Curtain principle
  - 3) Indemnity principle
- Boundaries – should they be guaranteed?
  - no
- Most modern land registration systems follow these principles
  - though indemnity may be provided by a non-state entity, e.g. professional notaries, rather than the State itself

## Issue:

- In land registry reform / land titling projects in developing countries, too much time and effort has been devoted to surveying and digitizing the boundaries of each parcel of land in the country
- This work is absolutely unnecessary, and has led to the failure of many of these projects

# Torrens System – Level of Survey Plan



Block has surveyed boundaries and Block # is referenced to a survey plan

Parcels are not surveyed – they are contained on a sketch

Region 08    Zone 006    Block 009    Parcel 02's unique PIN =    **08-006-009-02**

# Parcel Boundaries

- Surveying boundaries is too cumbersome, inefficient and unnecessary
- Sketch contains parcels referenced to each other within the block
- Boundaries of parcels are not surveyed, until such time as the property is transferred
- At that time, boundaries are settled, on a “going forward” basis
- State should not guarantee boundaries in any event

## Torrens-type parcel folio - Example

Element 1 - Property Description: **08-006-009-02**

[Plus Servitudes, Easements]

---

### Element 2 - Title

Date:	Title Holder	Instrument No.
01/01/2002	A Owner	005678432

---

### Element 3 - Encumbrances

Date:	Encumbrancer	Type	Instrument No.
01/01/2002	Bank One	Mortgage	005678433

## Torrens-type parcel folio - Example

Element 1 - Property Description: **08-006-009-02**

[Plus Servitudes, Easements]

---

### Element 2 - Title:

Date:	Title Holder	Instrument No.
<del>01/01/2002</del>	<del>A Owner (vender)</del>	<del>005678432</del>
01/11/2013	B Owner (purchaser)	007892345

---

### Element 3 - Encumbrances

Date:	Encumbrancer	Type	Instrument No.
<del>01/01/2002</del>	<del>Bank One (v's mortgagee)</del>	<del>Mortgage</del>	<del>005678433</del>
01/11/2013	Bank Four (p's mortgagee)	Mortgage	005678433

# Torrens System Variations

- State does not guarantee title
  - Instead, title is registered by legal professionals
  - In some systems:
    - qualified title is registered for a specific period of time (e.g. 3 years)
    - once time elapses, and no objections are lodged within that time, title becomes absolute
  - Or
    - legal professionals continue to “insure” the information they register, and there is no absolute title
- Conversion to a Torrens-type system – or variation – in many jurisdictions has been done on a “going-forward” basis
- Requires simple legal and institutional framework to make the conversion
- At time of conversion for each parcel, a survey plan of the individual parcel should be lodged with the registrar

# Tier One Registration Systems

- Deeds Registry
  - Public archive of deeds
  - “Grantor / Grantee” index to the archive
  - Register of proprietary interests in an asset
    - Not a title registration system – is a method for ascertaining identity of true owner, and their capacity to grant rights (including title or a security interest in the property)
  - Registration of a deed usually gives priority over an unregistered or subsequently registered instrument
  - Registration of a deed does not constitute registration of title
  - Land transfers required extensive and expensive searches to ensure that the vendor has a good “chain of title”
- Notice-filing system for movable property is derived from a deeds registry system
  - The notice contains an elaborate version of a grantor/grantee index, referenced to an asset or pool of assets, with a comprehensive priority scheme that functionally mirrors to a large extent the priorities or outcomes where there are competing proprietary interests

# Tier One Registration Systems - Movables

- Notice-filing for security interests in movable property
  - Derived from a deeds registry system
  - US, Canada, NZ, Australia, and an increasing number of emerging economies
    - Notice filed in public depository
    - Security agreement (the instrument creating the charge) is privately archived
  - Does not guarantee the validity of the security agreement
    - However, the threshold for validity is very low, and the essential elements would be found in most security agreements
    - Accordingly, most security agreements are valid
  - Does not deal with title to an asset
    - Does not need to – there are other ways of ensuring that the grantee has title or “rights in the collateral”
  - Would this system work for immovable property at the Tier One level?

# Tier One Notice-filing system for Immovable Property

- Legal efficiency
  - Issues:
    - validity of ownership rights and the instrument purporting to transfer / encumber those rights
    - Authenticity of the parties to the transaction
  - Could a notice-filing system deal with these issues?
- Comparison with “pledge law” reform
  - Different issues
  - Immovable property interests are rarely uniquely private - woven into a web of public interests

# Difficulties of a Single Framework: State Interests

- Immovable property rights exist within national, regional, and/or municipal land use planning arrangements, environmental regulations, and tax systems
- Immovable property may also be encumbered by (public or private) rights of way or easements
- All of these factors are closely linked to the specific geographies of the parcel and a national physical plan
- How would a notice-filing system deal with these factors?

# Difficulties of a Single Framework: Nature of the Asset

- Movable
  - Limited economic life-span
  - Can be manufactured
    - Created and recreated time after time
    - Does not provide the basic necessities of life in the way that immovable property does
- Immovable
  - Infinite economic life-span (exception - destruction through e.g. environmental pollution)
    - provides three of basic necessities of life – food, water, shelter
  - Finite quantity - can be reshaped, but not manufactured
  - Surface, sub-surface rights, and space above the land (to a limited extent)
    - Water, minerals, hydrocarbons
  - Activity on any given parcel can have significant effect on neighbour's parcel or community

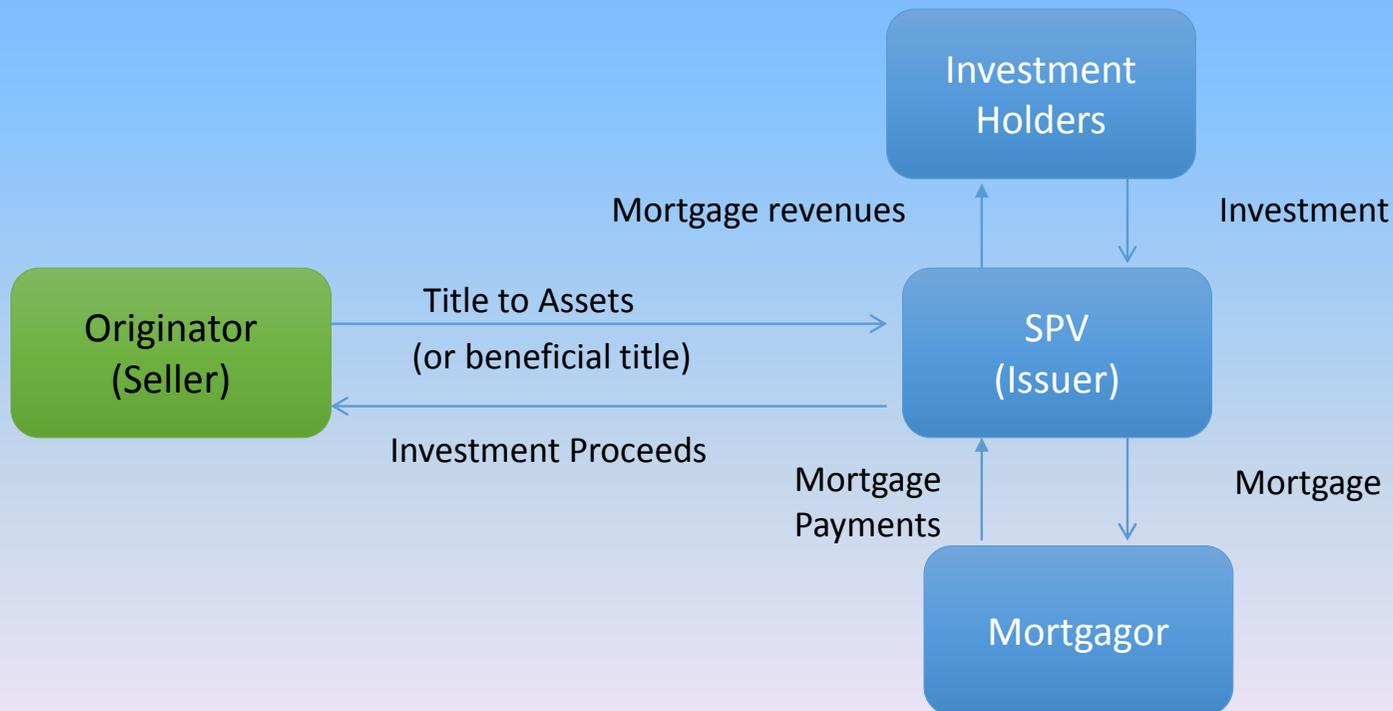
# Difficulties of a Single Framework: Immovables vs. Movable

- For First Tier transactions in immovable property, title is central to using the land as collateral
  - From a practical perspective, it often is for movable property as well
- Torrens system, or a modified version thereof (cadastral system) is efficient and creates the most certainty for first tier transactions
  - Problem in land reform has often been the insistence on mapping and guaranteeing boundaries, and State-guaranteed ownership

# Difficulties of a Single Framework: Immovables vs. Movables

- In modern financing models – regardless of the state of development in a country – from an economic perspective the first and second tiers of financing are inextricably interwoven
- Notice filing system for immovable property might be possible in the second tier, but not the first
- Without a credible first tier registry system, a second tier notice filing system for immovable property will be plagued by uncertainty, and it would be difficult to monetize the cash flow from first tier
- Why? Because second tier register is a derivative register - it relies on the accuracy of information in the first tier register
  - Example: the MERS-type register used in the US

# Tier Two System



Note: assignment of mortgage from Originator to SPV, assignment from SPV to other SPV's and financial intermediaries, are all assignments of the original mortgage - Including the land rights - and in most systems these transactions would require registration in the land registry. Hence MERS in the US

# Tier Two Registry System

- MERS (Mortgage Electronic Registration System) the original mortgagee remains as the nominal beneficiary or mortgagee of record
- MERS members record transfers of mortgages amongst themselves on the MERS register
  - All entities in the chain from Originator need to be members of MERS for it to work – from Originator (or other holder of the legal interest in the mortgage) through to the holder of beneficial interest, seeking to enforce the mortgage
- A notice filing system is possible within MERS-type registries

# Tier Two Registry System

- BUT: these two registry systems are related, and uncoupling is an issue
  - Creates uncertainty
  - Legislative framework would need to contain provisions that
    - The shell group (MERS) is a valid party of record on the first tier register and
    - That the member of the shell group on the second tier registry is entitled to exercise legal remedies upon default, provided they have registered on the second tier register (incentives)
- Why is it important to ensure that first tier information accurately reflects encumbrance on title?
  - Because the second tier register contains derived information that affects title

## Other Issues: Access and Fraud

- Modern digital registry systems raise the issue of access and fraud
  - Note: this always existed, even with paper-based systems
  - Digital:
    - Who should have access to the land registry?
    - “Read not write” access for the public?
- Would a notice-filing system facilitate fraud more than the other traditional systems?
  - Validation of documents
  - Authentication of the parties

## Other Issues – technological innovation

- Have we become fixated on notice-filing systems, because of the success of Article 9?
- Have technological innovations overcome some of the issues that the parties who created Article 9 needed to resolve?
- Are notice-filing systems suitable for all contexts?

# Other Issues: Land Reform

- Is the quest for a notice-based system an admission of failure at land registration reform?
  - There are different models / approaches that have been tried over the last few decades
  - This reform should not be abandoned, merely because the wrong model was used
- Suggestions
  - Torrens-type system, or modified version
  - Amended on a “going forward” basis, and back-filling when possible
  - Abandon the idea that boundaries need to be recorded and guaranteed
    - Work with hand-held GPS and sketches instead
  - In the process of obtaining the physical coordinates, obtain possessor’s information as well
  - Provide a “qualification period” before the information on the register becomes indefeasible
  - Create a special tribunal to resolve disputes
  - The model must have a way of ensuring authenticity of the parties, and validity of title

# Conclusion

- Assume two tiers of registry systems operating
  - One is traditional land registry, the other is a notice-filing system
- The second tier only operates because it refers to information derived from the first
- Therefore, uncoupling the second tier from the first tier would cause chaos
- Leads back to getting the first tier registry system right

# Conclusion

- Even if the first tier is well-implemented, one of the most important parts of a registry system is to deter fraud
  - In common law deeds registry jurisdictions, lawyers ensure authenticity of the parties, authenticity of the documents, and that the vendor has clear title, prior to conveying real property
  - In civil law jurisdictions, notaries ensure that there is valid title prior to having the title inscribed in the land registry
  - In the Torrens system, the State usually guarantees the registry record
- All these models provide indemnity for members of the public that rely on information within the registry
- Who would provide this indemnity in a first tier notice-based system?

# Conclusion

- If there must be two levels of registry systems:
  - Ensure that the first level contains credible information linked to parcel description
    - And If you are going to that extent, what would a notice-filing system add that a Torrens system doesn't already have?
    - Link the second level / tier registry system to the first with a strong legislative framework
  - Ensure that there is a means of compensating those who have a valid claim for restitution
    - Which party will provide insurance against fraud?
      - The State?
      - Notarial profession?
      - Title insurers?

# Questions & Comments

- Q1:
  - Discussion of “two tier” financing is not relevant in developing countries
  - Adequate notice to local financial institutions is sufficient to expand access to credit
- A:
  - Transactions undertaken by financial institutions are no longer local in a global economy
  - More importantly, multilateral agencies like the IFC depend on the two-tier system to invest in housing and infrastructure development in developing countries, often financing these projects at the senior or mezzanine level.
    - See, for example, [IFC Structured Finance Solutions: Securitization](#)
  - IFC would have difficulty getting investment-grade ratings for the bonds if the first tier is not registered properly – notice filing would be inadequate
  - Second tier is inextricably linked to first tier, developing country or not, in modern financing models.

# Questions & Comments

- Q2:
  - In many situations the validity of the documents is an issue. Notice filing would solve that problem.
- A:
  - With immovable property, courts in all countries will always want validation of title in some form
    - Deed / registration or adverse possession (holding the property in a manner that conflicts with the true owner's rights for a lengthy, specified period)
    - Without validation, how can the ownership interest be encumbered?
    - Could a squatter grant a mortgage in the property they possess for a month?
    - Title is crucial to our sense of the right to immovable property. The same is not true with movable property
    - Movable property: possession is often seen as a significant indicia of title. For that reason, notice filing system for movable property works – debtor's "rights in the property" are assumed on the basis of apparent control
  - We don't have ownership registers for movable property, except large ticket items like motor vehicles, aircraft, and ships
    - even where we have notice filing for these assets, we note the titleholder's right to the asset!