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GUIDE

A guide to the Security Interests (Jersey) Law 2012

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1 Introduction

Taking security over shares, bank accounts, rights under contracts and other types of intangible movable property in Jersey is governed by the Security Interests (Jersey) Law 2012 (the **2012 Law**). The 2012 Law provides Jersey with a modern regime for the creation and enforcement of security interests in intangible property. It also provides a statutory regime for the assignment of receivables.

The principal features of the 2012 Law are that it provides for:

- taking security in present and after-acquired intangible property, proceeds and book debts in one agreement (ie all asset security);
- securing obligations as to future advances;
- third party security;
- a grantor to be able to retain power to deal with collateral without prejudicing the security interest;
- rules governing the perfection and priority of outright assignments of receivables;
- registration of security interests and assignments of receivables;
- a set of priority rules, including protection against general insolvency creditors; and
- wider enforcement powers for secured parties than had previously existed.

2 The nature of a security interest under the 2012 Law

A security interest is an interest in intangible movable property that is created pursuant to a security agreement and secures payment or performance of an obligation.

There are four conditions that must be satisfied for the 2012 Law to apply:

- the transaction must involve the creation of a security interest in an asset in favour of the secured party;
- the asset must be intangible movable property;
- the security interest must arise by agreement between the parties; and
- the security interest must secure payment or performance of an obligation.

3 Property that can be secured under the 2012 Law

3.1 Original collateral

The 2012 Law permits the creation of a security interest in intangible movable property situate in Jersey. Under the 2012 Law, security may, for example, be taken over:

- negotiable instruments and bearer instruments (**documentary intangibles**) situated in Jersey;
- securities listed on a register maintained in Jersey or maintained by a Jersey company, limited liability partnership or foundation (a **Jersey body corporate**) or by an individual whose principal place of business or residence is Jersey (a **Jersey individual**) (**registered securities**); and
- bank accounts and securities accounts maintained in Jersey.

Parties may agree that the 2012 Law will apply to a security agreement between them that relates to intangible property wherever situate.

3.2 Proceeds

'Proceeds' are identifiable or traceable intangible movable property that is derived directly or indirectly from a dealing with the original collateral or from a dealing with its proceeds and in which the grantor acquires an interest. Proceeds include a right to an insurance or indemnity payment for loss or reduction in value of collateral. They do not include interest, dividends or other income (although these can be secured as original collateral). The 2012 Law provides for security interests to be able to apply to proceeds and treats a security interest in proceeds as an extension of the original security interest so that it has the same priority as the security interest in the original collateral.

A security interest in original collateral that is dealt with and that gives rise to proceeds continues in the original collateral unless the secured party authorised the dealing and extends to such of the proceeds as are intangible movable property situate in Jersey.

4 Creation of a security interest under the 2012 Law

There are two steps in the creation of a security interest under the 2012 Law: attachment and perfection.

4.1 Attachment

When a security interest attaches to collateral the security interest becomes enforceable against the grantor with respect to that collateral. A security interest attaches to collateral when the following conditions are satisfied (or at such later time as the parties agree):

- value has been given in respect of the security agreement;
- the grantor has rights or the power to grant rights in the collateral to a secured party; and
- one or both of the following conditions are satisfied:
  - the secured party or someone on its behalf (other than the grantor or obligor) has **possession** or **control** of the collateral; or
  - a security agreement is signed by or on behalf of the grantor and it identifies the collateral.

A secured party takes **possession** of a documentary intangible by having actual possession of the certificate of title to it.

A secured party takes **control**:

- of a registered security by being registered as the holder of it or taking possession of the certificate of title to it;
- of a bank account by:
  - the account being transferred into the name of the secured party;
  - the account bank agreeing in writing to act on the secured party's instructions;
  - the account being assigned to the secured party and notice of the assignment being given in writing to the account bank; or
  - the secured party being the account bank (a **charge-back**); and
- of a securities account by the same methods as a secured party can take control of a bank account, except by assignment.

4.2 Perfection

Perfection of a security interest protects the secured party's priority against subsequent secured creditors and an outright acquirer for value and it avoids invalidation of a security interest on a grantor's insolvency.

A security interest is perfected when the security interest has attached and any further steps required under the 2012 Law for perfection have been completed. The order in which attachment and perfection take place makes no difference.

There are three methods of perfection:

- **control** of registered securities, bank accounts and securities accounts (**financial collateral**);
- **possession** of documentary intangibles; or
- **registration** of a financing statement in respect of any type of collateral.

Control and possession simultaneously produce attachment and perfection. It is, therefore, not necessary to register a security interest in financial collateral or documentary intangibles in order to perfect a security interest in such collateral, but it is possible and it may be prudent to do so. Registration is the only way to perfect a security interest in income rights, contract rights and receivables. Registration is considered below.

There are three other types of perfection: automatic, continuous and temporary.

Automatic perfection is where a security interest in favour of an intermediary attaches to a person's securities and is automatically perfected if the intermediary pays for the securities and credits them to the person's securities account held with the intermediary before the person repays the intermediary.

Continuous perfection is where a security interest in proceeds is treated as automatically and continuously perfected and arises if the security interest in the original collateral is perfected by registration and the proceeds are:

- of the same kind as the original collateral or otherwise referred to in a financing statement;
- cash in a bank account; or
- insurance proceeds.

Temporary perfection is where a security interest is treated as automatically perfected but the perfection is only temporary. It arises in three circumstances:

- a security interest in proceeds that is not otherwise continuously perfected (eg because the security interest in the original collateral is not perfected by registration);
- a purchase money security interest (which is a security interest taken by a seller to secure the obligation to pay the purchase price of collateral or by a person advancing funds for the purchase of collateral); and
- a perfected security interest is taken under foreign law in collateral that is moved to Jersey from another jurisdiction.

If perfection of a temporarily perfected security interest is to be continuous, the secured party needs to take action to re-perfect it before expiry of a 30 day grace period. If this is not done, for priority purposes, the security interest will be treated as perfected only from the time of actual re-perfection.

4.3 Registration

An important feature of the 2012 Law is provision for electronic registration of security interests and assignments of receivables on a public register accessed on-line. The registration system is based on the identity of the grantor and not the assets and on the principle of notice filing and not transaction filing, so transaction documents are not filed.

Initial registration is by the on-line filing of a financing statement that gives notice to third parties of basic information including the existence of the security interest (or the assignment of a receivable), the identity of the parties and a description of the items and classes of collateral (or the receivable assigned).

It is also possible to file a financing change statement that records a transfer, assignment, subordination, discharge, amendment or other action or matter in respect of a security interest (or an assignment of a receivable) that has already been registered.

A financing statement or a financing change statement may relate to one or more security agreements or assignments of receivables and may be registered before or after a security agreement is entered into, an assignment of a receivable occurs or a security interest has attached.

The registration of a financing statement or a financing change statement is effective until:

- the registration is removed or discharged;
- the period for registration (if any) provided for in the statement expires; or
- if no period of registration is provided for in the statement, ten years from the date and time at which the statement was registered.

The registration of a financing statement or a financing change statement may be renewed by registering a financing change statement in respect of the earlier registration at any time while the earlier registration is effective.

The grantor or anyone else with an interest in collateral described in a financing statement may serve a demand on a secured party requiring it to register a financing change statement within 30 days in order to amend or discharge the registration, as appropriate, if:

- the secured obligations under a security agreement have been performed;
- the secured party has agreed to release all or part of the collateral;
- if a registration extends to property that is not collateral under the terms of a security agreement; or

- no security agreement exists between the parties named in the registration.

Failure to comply with such a demand gives the person serving the demand the right to apply to the registrar to have a financing change statement registered. The registrar must register the financing change statement unless the secured party serves a notice of objection on the registrar and the person serving the demand within 30 days of service of the demand. In such case, the person serving the demand can apply to court for an order that the registrar must register the financing change statement.

Registration of a financing statement or a financing change statement does not constitute constructive notice of the existence of the statement or of its contents. If it were otherwise, it would override the special priority rules considered below.

5 Priorities

5.1 General priority rules

The general rules regarding the priority of security interests are that:

- a perfected security interest has priority over an unperfected security interest;
- between continuously perfected security interests, priority goes to the secured party who was first to:
  - register a financing statement;
  - take possession or control of the collateral; or
  - temporarily perfect a security interest; and
- priority among unperfected security interests is determined by the order of attachment.

Priority of a perfected security interest is not necessarily based on the time of perfection. If a financing statement is registered in advance of the conclusion of a security agreement and the grantor then grants a security interest to another party which is perfected first then, although the perfected security interest initially has priority, it will be subordinated to the first security interest once this has become perfected because the priority of the first security interest goes back to the time of registration of the financing statement.

5.2 Special priority rules

The 2012 Law also contains special priority rules that apply to financial collateral only and to which the general priority rules are subject. The two most important rules are:

- a security interest by way of control has priority over a security interest under which a secured party does not have control; and
- charge-backs of bank accounts and securities accounts have priority over a conflicting security interest held by another party.

Where it is possible to perfect a security interest by taking control, it will be preferable because it will prevent a grantor from transferring the collateral to a third party and the secured party will benefit from the special priority rule under which control trumps registration. Registration can serve as a back-up measure if the secured party has to surrender possession or control of collateral to the grantor.

The special priority of charge backs will be of concern to a secured party who is taking security over an account held with a Jersey bank. The secured party will either have to seek the agreement of the account bank not to take security or enter into a subordination agreement with the account bank to achieve priority given that a charge back will otherwise always have priority no matter when it is taken.

5.3 Priority of purchase money security interests

A purchase money security interest in intangible movable property (or its proceeds) has priority over another security interest in the same collateral given by the same grantor that is not a purchase money security interest, whenever perfected, provided that the purchase money security interest is perfected not later than 30 days after the day on which it attached, during which time it enjoys temporary perfection. Perfection is required so that a prior financier is not misled by the grantor's apparent unencumbered ownership of the new asset.

The rationale for conferring special priority on a purchase money security interest is that the financier whose advance led to the acquisition of an asset should be given priority over a general financier who has a security interest over after-acquired property and who would otherwise achieve a windfall addition to its security package. In addition, without a provision of this type, a grantor may be unable to obtain secured financing from other sources where a security interest has been given over the grantor's present and future assets.

5.4 Priority on transfer of security interest

A security interest that is transferred has the same priority as it had immediately before the transfer.

5.5 Subordination

A secured party may subordinate its security interest to any other interest and such agreement is effective according to its terms between the parties to it.

Subordination agreements may be used to reverse priority rules that would otherwise prevail, for example, where a grantor is seeking non-purchase money financing from a financier who is not the first to register a financing statement or where security is being taken over a bank account. An alternative to subordination is the discharge of prior financing statements where the relevant secured obligations have been performed.

A transferee of a subordinated security interest is not bound by a subordination agreement and can treat the transferred interest as continuing to be the senior interest unless, at the time of the transfer:

- a financing statement or financing change statement has been registered in respect of the subordination;
- the transferee is party to the subordination agreement; or
- the agreement transferring the security interest provides otherwise.

6 Taking free

While the priority rules deal with competing security interests, the 2012 Law contains rules on taking free that concern parties whose interest ranks in priority to and extinguishes an earlier security interest.

6.1 Purchaser for value of collateral

A person who acquires collateral for value takes it free of an unperfected security interest unless the security interest was created by a transaction to which the person was a party. This is so even if the acquirer knew of the existence or terms of the unperfected security interest.

6.2 Recipient of an obligor initiated payment

A third-party creditor who receives payment of a debt owing by an obligor (ie a person owing payment or performance of an obligation secured by a security interest, whether or not that person is the grantor of the security interest) where the payment is made by the obligor by means of:

- a negotiable instrument;
- an electronic funds transfer; or
- a debit, a transfer order, an authorisation or a similar written payment mechanism executed by the obligor when payment was made,

takes that payment free of any security interest in:

- the funds paid;
- any intangible that was the source of the payment; and
- any negotiable instrument used to effect payment.

This is so even if the third-party creditor had knowledge of the security interest at the time of payment unless, in receiving payment, the third-party creditor acts in collusion with the obligor to defeat the rights of a secured party.

The power given to the obligor to make a payment can be likened to a debtor's power under English law to pay creditors where the debtor has given an uncrystallised floating charge. Unless a debtor has

this power, it would be difficult to carry on business in situations where an all assets security interest has been given. The purpose of this rule is to ensure the efficacy of payments.

6.3 Holder in due course of a negotiable instrument

The 2012 Law does not change the law in relation to the rights of a person who is the holder in due course of a negotiable instrument (ie a holder in due course takes free from any defect in the title of his transferor).

6.4 Purchaser for value of securities

A person takes free of a security interest in favour of another party even if that person knows of such security interest (unless that person knows that the disposition would be in breach of the relevant security agreement):

- if that person gives value for a registered security and takes possession of the certificate; or
- if that person gives value for a security held with an intermediary and the security is transferred to a securities account held in that person's name with the same or another intermediary.

The rationale for these rules is that a purchaser in the ordinary course of a seller's business should be entitled to assume that the disposition to it was authorised (which the seller's ability to deal with a security would indicate).

6.5 Purchaser for value of collateral appropriated or sold by secured party

A purchaser for value and in good faith of collateral appropriated or sold by a secured party takes the collateral free from:

- the interest of the grantor; and
- any interest subordinate to that of the grantor and the secured party.

A purchaser for value in good faith takes collateral subject to a security interest that has priority over the security interest that is enforced.

7 Enforcement and default remedies

7.1 Enforcement powers and their exercise

A secured party may enforce a security interest by doing any of the following in relation to the collateral or proceeds:

- appropriating it;
- selling it; and
- taking any of the following ancillary actions:
  - taking control or possession of it;
  - exercising any rights of the grantor in relation to it;
  - instructing any person who has an obligation in relation to it to carry out the obligation for the benefit of the secured party; or
  - applying any enforcement remedy that the security agreement provides for that is not in conflict with the 2012 Law.

The power of appropriation or sale can be exercised more than once. A secured party may sell the collateral by auction, public tender, private sale or another method. A secured party may buy any collateral that the secured party sells.

7.2 Notice of event of default

A security interest may be enforced when an event of default has occurred under the terms of a security agreement and the secured party has served on the grantor written notice specifying the event of default. Such notice can be served immediately after an event of default.

7.3 Notice of appropriation or sale

Not less than 14 days before appropriating or selling collateral, a secured party must also give written notice of appropriation or sale to:

- the grantor;
- any person who 21 days before the appropriation or sale has a registered security interest in the collateral; and
- any other person who has an interest in the collateral and has, not less than 21 days before the appropriation or sale, given the secured party notice of that interest.

Notice of sale does not have to be given to the extent that:

- the collateral is a quoted security;
- the secured party reasonably believes that the collateral will decline substantially in value if it is not disposed of within 14 days after the event of default; or
- a Jersey court is satisfied that notice is not required.

Anyone entitled to receive a notice of appropriation or sale can waive this right. If the grantor waives this right (and there are no other registered or notified security or other interests), the secured party can enforce the security interest when it has served notice of an event of default. If the right is not waived by all entitled parties, a notice of appropriation or sale should be served at the same time as the notice of event of default and the 14 day notice period should elapse before the secured party proceeds with enforcement.

7.4 Duties of secured party

A secured party who appropriates or sells collateral owes a duty to: take all commercially reasonable steps to determine or obtain the fair market value of the collateral as at the time of the appropriation or sale; act in other respects in a commercially reasonable manner; and enter into any agreement for sale only on commercially reasonable terms.

7.5 Effect of grantor's bankruptcy

A secured party's power of appropriation or sale is not affected by the grantor's bankruptcy or the grantor (or the grantor's property) being subject to insolvency proceedings in Jersey or elsewhere. This is so whether or not the secured party holds title to the collateral. To the extent that an asset is subject to a perfected security interest, it does not form part of a bankrupt's estate. In general, subject to rules relating to preferences, transactions at an undervalue and extortionate credit transactions, a grantor's bankruptcy invalidates only a security interest or an assignment of a receivable remaining unperfected at the time of the grantor's bankruptcy.

7.6 Effect of enforcement on subordinate security interests

When collateral is appropriated or sold, all security interests that are subordinate to the security interest of the secured party who appropriated or sold the collateral are extinguished. Subordinate secured parties are left only with a personal claim against the grantor and the right to share in any surplus.

7.7 Statement of account

Within 14 days of collateral being appropriated or sold, the secured party must give to the persons entitled to receive a notice of appropriation or sale a written statement of account showing:

- the gross value realised by appropriation or sale;
- the secured party’s reasonable costs of enforcement, appropriation or sale;
- the net value or net proceeds; and
- the surplus owing by, or the debt owing to, the secured party.

7.8 Duty to account for surplus

If a secured party has appropriated or sold collateral, it must pay any surplus value over what is required to discharge the obligations that are owed to it to satisfy other claims in the following order:

- first, any person who has a subordinate security interest in the collateral and who has registered a financing statement (that was effective immediately before the appropriation or sale) and, if more than one, in order of priority;
- then, any other person (other than the grantor) who has given the secured party notice that it claims an interest in the collateral and in respect of which the secured party is satisfied that that person has a legally enforceable interest therein; and
- finally, the grantor.

In cases of doubt, a secured party can pay the surplus into court.

7.9 Redemption and reinstatement

The persons entitled to receive a notice of appropriation or sale may redeem the collateral. The grantor's right to redeem has priority over anyone else's right to redeem.

Redemption entails either the grantor or a junior secured creditor paying off the secured obligations and paying the reasonable costs incurred by the senior secured creditor in enforcing the security. It results either in the termination of the security agreement and re-vesting of the collateral in the grantor or the redeeming creditor taking an assignment of the senior security. The right of redemption is exercisable at any time prior to the exercise by the senior secured party of its power of appropriation or sale. The right to redeem may not be excluded or modified by agreement.

Reinstatement of a security agreement, on the other hand, requires the grantor to pay arrears, remedy other accrued defaults and to pay the reasonable costs of enforcement incurred by the secured party. This revives the security agreement so that the grantor continues to enjoy the benefit of contractual provisions for repayment by instalments. The right of reinstatement is exercisable at any time prior to the exercise by the secured party of its power of appropriation or sale. The right of reinstatement can be waived.

8 Assignment of receivables

For the purposes of the 2012 Law, a receivable is a monetary entitlement, whether or not earned by performance, arising from the supply of goods or services (other than insurance services) or the supply of energy, but does not include a loan, a bank account or a right to payment embodied in a negotiable instrument or a security. The definition, therefore, covers credit provided in connection with the delivery of goods or the provision of services (other than insurance, lending or banking). This would, for example, apply to credit card receivables, hire purchase contracts for goods or credit for travel services, but not overdrafts or loan facilities. The more traditional term 'book debt' has been replaced by 'receivable' because debts are no longer recorded in books but electronically. The 2012 Law only applies to an assignment of a receivable payable by a Jersey body corporate or a Jersey individual.

Assignments of receivables and further assignments of receivables, whether absolute or by way of security, are subject to the 2012 Law's perfection and priority rules. Accordingly, they must be registered in order to be perfected. Notice to the debtor does not suffice. The rationale for this is that receivables are significant assets the assignment of which ought to be visible to intending financiers. The effect of making the assignment of receivables subject to the 2012 Law's perfection and priority rules is that it overrides any customary law rule that a purchaser of a receivable must give notice of the assignment to perfect title to it and the corresponding priority rule by which a later assignee of a receivable who makes an advance without notice of a prior assignment obtains priority.

The 2012 Law also introduces a series of rules in relation to assignment of receivables.

First, a rule has been introduced to ensure the free transfer of receivables by overriding contractual prohibitions on assignment. If an assignment of a receivable (whether or not by way of security) is made in breach of a contract term prohibiting or restricting assignment, the contract term is binding on the assignor only to the extent of making the assignor liable in damages for the breach. The contract term is not

effective against the assignee, nor would it affect the validity of the assignment. This rule is intended to facilitate receivables financing and securitisation.

Secondly, an account debtor is bound by an absolute assignment of a receivable but has a duty to pay the assignee only if written notice of the assignment is given by the assignor to the account debtor and the notice identifies the account assigned and requires the account debtor to pay the assignee. If an account debtor makes a payment to the assignor, the payment discharges the obligation (to the extent of the payment) only if the account debtor does not know about the assignment. This rule protects an account debtor who, although he is bound by an absolute assignment, may not have received notice of it.

Thirdly, the rights of an assignee of a receivable that has been assigned (absolutely or by way of security) are subject to any defences to the assigned claim and any rights of set-off that the account debtor could have asserted against the assignor accruing before the account debtor became aware of the assignment.

Assignments of receivables are subject to priority rules that are similar to the priority rules that apply to security interests:

- a perfected assignment of a receivable has priority over an unperfected assignment of, or an unperfected security interest in, the same receivable;
- a perfected security interest in a receivable has priority over an unperfected assignment of the same receivable;
- between continuously perfected security interests in, or perfected assignments of, the same receivable, priority goes to the secured party who is first to:
  - register a security interest or assignment; or
  - temporarily perfect a security interest;
- priority among unperfected assignments of the same receivable is determined by the order in which they occurred; and
- in the case of competing unperfected security interests in, and unperfected assignments of, the same receivable, priority is determined by the order of attachment or assignment.

9 Transitional provisions and other legislative amendments

The Security Interests (Jersey) Law 1983 (the **1983 Law**) continues to apply to a security interest created before the 2012 Law came into force (an **old security interest**) if that security interest was still in force when the 2012 Law came into force on 2 January 2014. Enforcement of an old security interest would take place in accordance with the 1983 Law.

An old security interest has priority over a 2012 Law security interest over the same collateral (unless otherwise agreed). An old security interest over a receivable has priority over a 2012 Law assignment of the same receivable (a **new assignment**) whether or not the new assignment is perfected under the 2012 Law (unless otherwise agreed).

If an old security interest is amended after 2 January 2014, the old security interest as amended is taken to be a security interest created under the 2012 Law. A security agreement is amended for these purposes if the secured obligations, the security period, the collateral or its other terms are amended. Accordingly, the timing of creation dates from the amendment, effectively running the risk of losing priority and the benefit of hardening periods. If this raises concerns, an alternative approach may be to leave the old security agreement in place and to enter into a new second ranking security agreement. Consideration should also be given as to whether:

- a secured party can utilise further assurance provisions or other means in order to require a borrower to amend existing security or grant new security; and
- security should also be taken over a borrower's securities accounts and receivables.

Registration does not affect the priority of two old assignments as against one another but does determine priority as between an old assignment and a 2012 Law assignment. A perfected security interest created under the 2012 Law over a receivable has priority over an old assignment of the same receivable that is not perfected at the time the security interest is perfected. Furthermore, by perfecting the assignment by registration, it becomes unaffected by bankruptcy.

10 Overview

The 2012 Law was a leap forward in the sophistication of the Jersey security interests regime. This sophistication has translated into greater certainty and flexibility when taking security interests compared to the 1983 Law. The 2012 Law is modelled on the Personal Property Security Acts (**PPSAs**) of New Zealand and the Canadian states and this will allow courts and practitioners in Jersey to look to the well established practice and precedent of these other jurisdictions for guidance. Whilst the 2012 Law is more complex than the 1983 Law, it is, nevertheless, simpler and more creditor friendly than other PPSAs as it has been tailored to meet the needs of Jersey as a leading international financial centre.

The ability under the 2012 Law to:

- take all asset security;
- register security interests; and
- exercise a comprehensive range of enforcement remedies,

was a welcome development in Jersey security law that has enhanced Jersey's attractiveness as a jurisdiction in which to undertake secured lending. The 2012 Law will be extended in due course to permit the taking of security interests in tangible movable property.

11 About us

Mourant Ozannes (Jersey) LLP has an international reputation as one of the leading Jersey banking and finance practices. We act for lenders, borrowers and other finance parties, advising 90 per cent of the world's top 50 banks.

12 Contacts

A full list of contacts specialising in financial services can be found here.

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