



Corporate

# The New Security Interests (Jersey) Law 201- (the "New SIL") (yet to come into force)



September 2011

## 1. Introduction

The New SIL was passed by the States Assembly on 19 July 2011. It has been sent to the Privy Council for approval, after which it is likely to come into force in the first quarter of 2012. Like the existing Law of 1983, the New SIL legislates for the creation of security interests in intangible movable property.

Amongst other things, the New SIL:

- (a) specifies when Jersey law applies for taking security (and when compliance with New SIL is obligatory for taking security under Jersey law);
- (b) confirms that direct third-party security can be taken;
- (c) has separate clearly articulated treatment of attachment and perfection;
- (d) sets out a clear ranking of priorities;
- (e) confirms it is possible to take security over property acquired in the future, i.e. to provide for creation of the security interest in an agreement entered into before the property is acquired;
- (f) specifies when security attaches to proceeds of collateral;
- (g) widens the enforcement powers and options available to secured parties;
- (h) establishes a searchable public register of security interests;
- (i) strengthens the position of the holder of a security interest in the insolvency of the grantor of the security; and
- (j) sets out clear transitional provisions dealing with existing Jersey security agreements entered into under current legislation.

## 2. To what security interests does New SIL apply? When is it mandatory?

The New SIL only applies (but see below) to security interests created over:

- (a) documentary intangibles (i.e. negotiable instruments and negotiable investment securities) situated in Jersey;
- (b) directly-held non-negotiable investment securities listed on a register maintained in Jersey, or by a Jersey person;

- (c) investment securities held through a securities account with an intermediary where the account is maintained in Jersey;
- (d) deposit accounts (meaning bank accounts generally) maintained in Jersey; and
- (e) other intangibles (such as receivables or contract rights) where the debtor or other person owing the obligation is a Jersey company or Jersey individual.

Security interests in those categories of property can only be created under Jersey law in accordance with New SIL.

The New SIL does not deal with tangible goods, money (i.e. currency) or documents of title to tangible goods.

The New SIL also permits parties to agree that the New SIL shall apply to intangible movables situated anywhere in the world, though this agreement will regulate only the relations between those parties, and will not affect the rights of third parties.

Certain interests are outside the scope of, and are not affected by, the New SIL, such as (as under the existing law), liens and rights of set-off. There is a further list of interests arising from specified transactions which are outside the scope of New SIL, including - to give one example - a transaction that is a transfer of present or future wages or salary.

## 3. Can a Jersey Entity Grant Foreign Law Security?

Yes. The New SIL affirms the current position that Jersey persons have capacity to grant security governed by foreign law over assets situated outside Jersey.

## 4. Is Third Party Security permitted, without using a guarantee?

Yes. The New SIL expressly states that a security interest may be created to secure the obligation of a third party. This removes the need to take a guarantee or parallel debt obligation from the grantor of the security in order to have a personal obligation of the grantor. (Parallel debt obligations will still be needed where the security is held by a security trustee.)

## 5. Will a Security Interest extend to After-Acquired Property?

Yes. A security agreement can be expressed to extend to after-acquired property and the security interest attaches to it upon the grantor acquiring that property, without the need for any further steps to be taken.

## 6. Can Security be given for Future Advances?

Yes. If the security agreement provides that the secured obligations may include obligations as to future advances, the security interest is not extinguished by repayment of a current advance. One can therefore have security for a fluctuating overdraft account. The priority of the security for those future advances is the same as for the original advance.

## 7. Does Security Extend to Proceeds?

Yes, it can. A security interest in collateral that is dealt with or otherwise gives rise to proceeds: (1) continues in the collateral (unless the secured party expressly or impliedly authorised the dealing); and (2) extends to proceeds which are of a type within the scope of the New SIL.

**Proceeds:** "Proceeds" means intangible movable property that is derived directly or indirectly from a dealing with collateral or from a dealing with proceeds of that collateral, i.e. proceeds of proceeds. It includes a right to an insurance payout for loss of collateral or proceeds of collateral. (It does not include interest, dividends or other income derived from collateral, so secured parties need to identify these as primary collateral if security in them is sought.)

## 8. How is a Security Interest Created?

**Agreement:** a security interest under the New SIL can only be created by agreement, i.e. such a security interest can't arise by operation of law.

**Attachment:** 'Attachment' denotes the creation of a security interest in collateral, enforceable against the grantor. A security interest can only 'attach' by agreement. The basic rule is that a security interest attaches when:

(a) value is given for the security agreement; and

(b) the grantor has rights in the collateral, and the secured party either:

- has possession or control of the collateral; or
- the security agreement is in writing and contains a description of the collateral sufficient for it to be identified,

or at any later time the parties agree.

'Value' is widely defined, and can be money or money's worth provided by anyone, i.e. not just by the secured party.

Note that security agreements do not always have to be in writing.

**Control:** The New SIL contains detailed provisions dealing with the meaning of control. The New SIL also states that allowing the grantor to substitute equivalent collateral or to withdraw excess collateral does not of itself mean that collateral is not under the control of the secured party.

Specific rules determine how "control" of deposit accounts, securities accounts, certificated investment securities and uncertificated investment securities held in a settlement system (such as CREST) is achieved.

The New SIL does not say anything on the meaning of 'possession'.

## 9. Is it possible to take a 'whole undertaking' security interest akin to a Debenture?

The New SIL deals only with intangible movable property. A security interest under the New SIL will not extend to tangible goods, money (i.e. currency) or documents of title to tangible goods. One can have a security interest agreement which identifies the collateral as "all present and future intangible movable property" of the grantor. Whilst the security interest would 'attach' to "all present and future intangible movable property" of the grantor, in order to obtain priority and the other protections given by 'perfection', the secured party will need to 'perfect' its security interests in accordance with the method(s) applicable to each relevant asset type (see paragraph 11 below).

Jersey law does not have any separate category of 'floating security interest', corresponding to an English floating charge, with different standing in insolvency but the New SIL helpfully says that attachment of a security interest is not affected if a secured party permits a grantor to retain, in the absence of a contrary direction from the secured party, the right to deal with the collateral, without a duty to account for the proceeds or to replace collateral. This affords both the grantor and the secured party a reasonable degree of practical flexibility.

## 10. Can a bank hold security in a 'deposit account' held with it?

Yes. The New SIL expressly provides that a deposit-taking institution can take a security interest over its own obligation to a depositor in respect of a 'deposit account'. Similarly, an intermediary may also take a security interest in its own obligation from the holder of a securities account.

## 11. What Does 'Perfection' mean?

**Perfection:** Perfection is necessary to protect priority, and to gain protection against third parties, which is particularly important in insolvency. The method of perfection depends on the kind of collateral, but in all cases there is no perfection without attachment, and in some cases attachment (see paragraph 8 above) is itself the only perfection needed: the most extensive change in this area is however the creation of a public, searchable, on-line register of 'financing statements'. Registering a financing statement is a means of 'perfecting' a security interest. Financing statements will summarise transactions and give basic information as to the identity of parties and descriptions of the relevant collateral (and preferably of potential proceeds of the original collateral) in each transaction. Registering a copy of the security agreement itself is not required. The perfection rules are as follows:

- (a) A security interest in a **documentary intangible** (meaning a negotiable instrument or negotiable investment security) is perfected by possession of that collateral by the secured party. Since security in a documentary intangible will be taken by possession, no further perfection step will be required.

- (b) A security interest in a **deposit account, a securities account maintained by an intermediary, a certificated investment security or an uncertificated investment security held in a settlement system** is perfected by control of that collateral by the secured party. (Again this means that for these types of collateral, attachment and perfection are effected in the same step.)

- (c) A security interest in **collateral of every type** can be perfected by registration (see below). The only exception is that a security interest in favour of an intermediary both attaches to investment securities, and is perfected, if (i) the grantor buys investment securities through the intermediary, (ii) is obliged to pay for them on or before the purchase, and (iii) the intermediary credits them to the buyer's/grantor's securities account before being paid for them. This security interest secures the purchase price.

- (d) An absolute assignment of receivables is perfected by registration.

**Registration:** Registration lasts for the period provided for in the financing statement, or if none is provided for, 10 years, but can be renewed.

To best protect its position, a secured party can also register a financing statement before the conclusion of a security agreement.

## 12. Priority Rules

The New SIL contains some basic priority rules, and some special priority rules. The basic rules apply in the absence of an applicable special rule.

### (a) Basic Priority Rules:

- (i) Perfected security interests have priority over unperfected security interests.
- (ii) Where there are 2 perfected security interests, priority goes to the first to register a financing statement, take possession or take control of the collateral.
- (iii) Where there are 2 unperfected security interests, priority goes to the first to 'attach'.

**(b) Special Priority Rules:**

Special priority rules apply to receivables, certificated investment securities, securities accounts and deposit accounts. For example, a security interest held by an intermediary in a securities account opened with the intermediary, or held by a bank in a deposit account opened with the bank, has priority over a conflicting security interest held by another person.

**(c) Subordination:**

A secured party can agree to subordinate its security interest to that of another. Paragraph (a)(ii) above means that when taking security over accounts, one will need to engage with the deposit bank or intermediary either to secure a subordination of the deposit bank's (or intermediary's) existing security interest or an agreement not to create any security interest in the future.

Details of subordination agreements can also be registered by financing statement.

**(d) Purchase Money Security Interest (PMSI):**

A PMSI is: (i) a security interest taken in collateral by a seller as security for vendor finance provided on sale of the collateral to the grantor; or (ii) a security interest taken in collateral to the extent that it secures money/value advanced to the grantor for the purpose of, and actually used in, acquiring the collateral.

A PMSI has priority over a security interest that is not a PMSI, so long as the PMSI is perfected within 30 days of attachment.

**13. Enforcement**

**Enforcement Options:** Under current law, enforcement powers expressly provided for by the statute are limited to: (i) (in terms) appropriation of money; and (ii) sale of the collateral. Appropriation and sale remain the primary remedies of the secured party under New SIL but in addition to these, the New SIL permits:

(a) appropriation of other types of collateral or proceeds and application of them in satisfaction of secured obligations;

(b) taking control or possession of collateral or proceeds;

(c) exercising any of the rights of the grantor in relation to the collateral or proceeds (e.g. voting rights and/or the right to receive dividends (although you can also control these prior to default, by contract)); and

(d) instructing any person who has an obligation in relation to the collateral or proceeds to carry out the obligation for the benefit of the secured party (e.g. directing the actions of an intermediary who holds a securities account for the grantor).

The New SIL also permits the parties to agree any other remedy to the extent that it is not in conflict with the New SIL. Enforcement powers can therefore be tailored to fit the transaction and precise nature of the collateral. Further, the New SIL provides that the powers/remedies in paragraphs (a) – (d) above, and other permitted agreed remedies, are not mutually exclusive, except where mutually inconsistent; and it provides that these powers and remedies are not exclusive of other rights of the secured party that the parties may agree (if not in conflict with the New SIL).

Ultimately, the secured party can also apply for an order of the Court to support its enforcement rights.

**How Do I Enforce?:** The power of enforcement becomes exercisable once an event of default has occurred and written notice of this fact has been served on the grantor.

If the secured party wants to appropriate collateral, it must give the grantor 14 days prior written notice of appropriation.

The same notice must be given to any (other) person who, 21 days before the appropriation, has a registered security interest in the collateral, or has by that time given the secured party notice of its interest in the collateral. (A search of the register will clearly need to be made 21 days prior to the appropriation, in order to determine who to give notice to.)

The same rules apply to a sale of collateral, except where:

- (a) the collateral is a quoted investment security;
- (b) the secured party believes on reasonable grounds that the collateral will decline substantially in value if not disposed of within 14 days; or
- (c) for any other reason, a court is satisfied on an *ex parte* basis that notice is not required.

An important change from the existing statutory regime is that the parties may agree in writing that no notice of appropriation or sale is required, or that a different notice period should apply (but note that this affects the requirement to give notice to that person only.) Note also that the notice requirement itself applies only to appropriation or sale, and not to any other enforcement power or remedy.

Although the New SIL allows the secured party a wide range of powers and remedies, it does not introduce into Jersey law any concept resembling receivership under English law.

**Self-Sale:** The question of self-sale is less important now that secured parties can appropriate collateral other than money, but the New SIL expressly states that a secured party can effect a sale by auction, public tender, private sale or another method, and that the secured party itself can also buy the collateral on enforcement.

**What Duties are Imposed on the Secured Party?:** On appropriation, the secured party must "take all commercially reasonable steps to determine the fair market value" of the collateral.

In a sale, the secured party must "take all commercially reasonable steps to obtain the fair market value" of the collateral.

In either case the secured party must otherwise act in a commercially reasonable manner.

These duties are owed to the grantor and to anyone with a registered security interest or who has given written notice of his/her interest in the collateral 21 days prior to the appropriation/sale, i.e. the same persons to whom notice of the appropriation or sale must be given.

Following appropriation or sale the secured party must give a statement of account to the grantor and other specified interested persons, and there are rules on when a surplus exists and the entitlement to that surplus of interested persons.

## 14. Protection of purchasers

A purchaser for value and in good faith of collateral that is appropriated or sold by a secured party takes free from the interest of the grantor, any interest subordinate to that of the grantor, and any interest subordinate to that of the secured party. This is the case despite any non-compliance with the provisions of New SIL on enforcement.

## 15. What is the impact of Insolvency on a Security Interest?

Where the grantor is bankrupt or subject to any insolvency order or proceedings consequent upon insolvency in Jersey or elsewhere, that fact shall not affect the enforcement powers of the secured party. This simple provision is a very important change from the more complex interrelated provisions of existing legislation. Note however that a security interest can still be challenged under the 'transaction at undervalue' and 'preference' regimes of relevant statutes, and that a security interest that is not perfected before the grantor becomes bankrupt is void against the Viscount (or a liquidator) and the grantor's creditors.

## 16. Taking Free

The general rule is that a third party who acquires collateral for value takes the collateral free of an unperfected security interest in the collateral.

Special rules apply in favour of (i) creditors who receive payment from an obligor - they do so free of any security interest in for example the funds paid - (ii) purchasers for value of certificated investment securities, or investment securities held with an intermediary, in each case whether or not the creditor or purchaser knows of the security interest, but subject to certain other constraints, and (iii) holders in due course of negotiable instruments.

## 17. What must be Registered?

Any security interest that is not perfected either by possession or control should be perfected by registration of a financing statement setting out details of the security interest. The registrar will serve a statement confirming registration and unless this right is waived in writing, the applicant for registration (generally the secured party) must deliver a copy of the registrar's confirmation to the grantor.

'Financing change statements' need to be registered in the case of transfers, subordination, amendments or discharges of security interests.

Registration of a financing or financing change statement is invalid only if the defect or other fault in the document is seriously misleading.

The register will be public and searchable and it is intended that it be accessed on-line.

Please also see the note on registration under 11 (Perfection) above.

Registering a financing or financing change statement does not constitute constructive notice or knowledge of the statement or its contents.

## 18. What are the Transitional Arrangements for existing Jersey security?

A security interest created under current law will be unaffected, that is the existing law will continue to apply to it, unless the exception below applies. It will – unless the secured party otherwise agrees - have priority over any new security interest in the same collateral, and there is no requirement to register a financing statement in respect of it.

The exception is where the continuing security interest is amended. 'Amend' is defined to mean:

- (a) adding an obligation not previously secured;
- (b) altering the terms on which an obligation is secured;
- (c) extending or reducing the duration of the security interest; or
- (d) adding to or modifying the collateral.

If an existing security interest agreement is amended, it becomes subject to the New SIL rules regarding attachment and perfection, so it is important that the correct steps are taken to ensure perfection (such as by registration). Secured parties may also want to amend existing documents to take advantage of the expanded set of enforcement options, and to negate the requirement for 14 days prior written notice of appropriation or sale of collateral.

## 19. Absolute Assignment of Receivables

The New SIL deals principally with the creation of security. However, it also deals with absolute assignments of receivables. It enables parties to perfect such assignments (only) by registration and to establish priority by registration or order of registration. A single registration can cover existing and future assignments between the same parties. Similar to the regime for security interests, registration can be made before the assignment occurs.

Quite apart from the perfection achieved by registration, the "account debtor" is only bound by the assignment if given proper written notice of it.

**New SIL overrides contract:** The New SIL overrides any provision in a contract that prohibits or restricts assignment of receivables. Any such provision is ineffective against the assignee. The restriction is binding on the assignor only to the extent that the assignor is liable in damages (to the debtor under the contract) for the breach of contract.

**Loans are not Receivables:** The definition of receivables expressly excludes loans, deposit accounts and rights to payments represented by negotiable instruments or investment securities. This does not however mean that one cannot take security in the right to repayment of a loan.

Transitional arrangements also apply to these non-security assignments, It seems that such an assignment made before New SIL comes into force will need to be registered for it to be valid in the insolvency of the assignor.

Normally when New SIL speaks of assignment it means non-security assignment.

# Contact us

For further information or professional advice please contact your usual Carey Olsen contact or any of our lawyers below.

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