

## **Appendix V**

### **Possible Changes to the Registration Regime of Charges That Have Been Considered But Rejected**

#### **(A) Comprehensively Codifying the Law on Priorities**

1. Under the current regime, while registration is not of itself a reference point for determining priorities, the holder of an unregistered but registrable charge is reduced to the rank of unsecured creditor in the event of the company creating the charge going into liquidation. Company charge registration is intended to prevent the implication of false wealth and its role in governing priorities appears to have developed almost by accident. It should be noted that the Australian model which seemingly sets out a comprehensive set of priority rules and the proposed Irish model which adopts a similar but less complex regime on priority rules do not, in effect, deal with all possible priority provisions. It seems that the present provisions are familiar to Hong Kong practitioners and there appears to be no demand for such rules to be restated in the CO.

#### **(B) Advance or Provisional Registration System**

2. Despite some overseas models, it is considered that there is no need to introduce a system of advance or provisional registration of company charges. Under such a system, registration could be effected before execution of a charge but the registration would lapse if a further or confirmatory registration is not made within a certain period of time. Provisional registration allows an intending charge holder to preserve its priority during negotiations for a loan by filing the requisite particulars in advance of the creation of the charge. The registered particulars provide notice of intention to take a charge and the priority of the charge is then determined by the date of the filing, even though this preceded its creation.
3. However, we are of the view that an advance or provisional registration system would not be more effective than the current regime in Hong Kong and consequently we do not recommend its introduction. One of the main reasons is that it would be a more complicated system as it requires registration of the same charge twice (i.e. provisional and final registration) and there is little information on how some overseas systems work as the relevant provisions have not yet been in force. Also, an advance/provisional registration system could easily be abused as

negotiations could take a long time to complete before the final registration and the borrower would then be tied to a lender whose charge is provisionally registered at the beginning of the negotiation.

**(C) Retention of Title Clause**

4. We do not recommend providing a legislative clarification of the kinds of retention of title clause that constitute a registrable charge. It appears that this has not been a major issue in Hong Kong, and it would be very difficult to provide a statutory definition. The question of whether a particular retention of title clause should be registrable is best decided by the courts as under the current practice.

**(D) Sale or Absolute Assignment of Book Debts**

5. We do not recommend bringing the sale or absolute assignment of book debts (or receivables), which is referred to as factoring, within the scope of the registration requirements. The CO currently only applies to the registration of charges and not to the registration of sales. In other words, a factoring transaction does not have to be registered but, where a company creates a charge over its debts, registration is a necessity. In the US under Article 9 of the UCC and in New Zealand under the Personal Property Securities Act, sales and charges over receivables have been assimilated for registration purposes. It is however considered that the sale/charge distinction should be maintained. The assignment of receivables is not a charge per se and should not be treated as such for registration purposes. While the Law Commission of England and Wales has recommended that absolute assignments, as defined narrowly and subject to certain exclusions, should be registrable, it should be noted that this recommendation has not been adopted in the CA 2006.

**(E) Pledges**

6. We do not recommend bringing pledges within the scope of the registration requirements. A pledge is a possessory security under which the security taker has possession either of the items given as security or of documents of title thereto. The class of assets capable of forming the subject-matter of a pledge is confined to goods and to documentary intangibles which are “documents embodying title to goods, money or securities such that the right to these assets is vested in the holder of the document for the time being and can be transferred by delivery with any necessary indorsement.”

7. A pledge is to be contrasted with a charge which is a non-possessory security. In the case of a charge there is no requirement of delivery of possession; either of the subject-matter of the security or of documents of title. Pledges do not come within the registration of charge provisions by reason of the fact that they do not constitute charges. Moreover, there is a rationale for not requiring registration of pledges in that possession of the assets, or of documents of title, by the security taker serves to alert third parties and, in particular, other creditors of the borrower to the possible existence of a security arrangement.

**(F) Trust Receipts**

8. We do not recommend bringing trust receipts within the scope of the registration requirements. A “trust receipt” is a document which permits a security taker (the pledgee) to release goods or documents of title back to the security provider (the pledgor) but under which the pledgor becomes an agent of the pledgee in respect of the sale of the goods and also a trustee of the sale proceeds. The arrangement allows the pledgee to maintain its pledge interest.
9. In the UK, the Law Commission recommended that “if negotiable instruments or documents of title have been pledged, or goods are held by a third party bailee to the order of a pledgee, and the collateral is released into the possession of the debtor for limited purposes such as sale, the pledge (and the pledgee’s interest in the proceeds) should be treated as a charge over the goods and their proceeds. The charge must be registered within 15 days unless the collateral is returned to the creditor’s possession before that time.”<sup>1</sup>
10. In the Hong Kong context however, long term trust receipts are far from being the norm and it would be difficult to prescribe a suitable period to trigger the registration requirement. If it is decided to delete the bill of sale provision without any specific replacement to cover charges over goods (see paragraphs 5.13 and 5.14 above), there would seem to be even less reason to require the registration of trust receipts which effectively represent a form of security over goods.

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<sup>1</sup> See Law Commission Consultative Report *Company Security Interests* (2004) at paragraph 3.112. It should be noted that the UK Companies Act 2006 did not adopt this recommendation.

## **(G) Insurance Policies**

11. Charges on insurance policies are not registrable under the current Hong Kong legislative regime if one applies, by analogy, the leading English case of *Paul and Frank Ltd v Discount Bank (Overseas) Ltd*<sup>2</sup>. In that case, it was argued unsuccessfully that a documentation which authorised the payment of the proceeds of an insurance policy to the defendant amounted to a charge on book debts.
12. In the UK, both the Diamond Report and the Law Commission of England and Wales have recommended the registration of charges over insurance policies. In view of the public notice function underlying the registration requirement, there might be a case to justify their inclusion<sup>3</sup>. However, the SCCLR considers that given the diversification of policies existing in the market, it is difficult to define “insurance policies”. Also, if a creditor sees a security over an asset, it would be logical for the creditor to expect that the security should extend to the insurance policy if the asset is insured. Unless the insurance industry advises otherwise, the SCCLR thinks that there should be no change in the law in this respect.

## **(H) Shares (and Other Marketable Securities)**

13. Currently a floating charge over shares is registrable under the CO (as all floaters are registrable) but a fixed charge (whether legal or equitable) is not. We have explored whether any reforms should be made in respect of registration of charges over shares and other marketable securities and three possible options for reform have been considered. The first is the Australian model where charges on shares and other marketable securities are registrable subject to the following exceptions: (i) a charge created in whole or in part by the deposit of a document of title to the marketable security; or (ii) a mortgage under which the marketable security is registered in the name of the chargee or a person nominated by the chargee<sup>4</sup>. The second is the Singapore model which makes a charge on shares in a subsidiary registrable. The third is the UK approach, as set out in the Financial Collateral Arrangement (No 2) Regulations, which expressly excludes registration requirements in respect of fixed charges on shares and floating charges on shares where the charge holder has control.

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<sup>2</sup> [1967] Ch 348

<sup>3</sup> It should be noted that the CA 2006 has not adopted the recommendation for inclusion.

<sup>4</sup> Section 262(1)(g) of the ACA. In other words it provides for registration unless the collateral taker has control over the document of title to the securities or the securities are registered in its name. Registration is not required since third parties will not be misled in such cases.

14. We are inclined not to make fixed charges on shares and other marketable securities registrable. It is considered that the present system in Hong Kong where fixed charges over shares are not registrable has not created any major problems. It is noted in particular that there might be strong market resistance to reform. Banks appear to prefer the present system as they have control over shares offered as security since such shares are often held in the name of chargee banks. Registration would be difficult in practice given the changing nature of investment portfolios which could result in frequent registration applications. There is also a trend in Europe and in the US, under the UCC, to remove registration requirements in respect of shares. Any change to make charges on shares registrable might also create problems if the securities market develops from a Central Clearing and Settlement System holding to scripless trading.