COLLATERAL REGISTRY REGULATION: Impact on Micro, Small and Medium Enterprises’ Access to Finance

BACKGROUND
In most jurisdictions across the globe, the creation of security interests in moveable properties are nearly or just as common and acceptable as real property especially amongst individuals and small businesses given that such security interests are more accessible and easily realizable.

The reverse is the case in Nigeria owing to the near non – existence of the legal and regulatory framework for the creation, protection and enforcement of security in movable property. This has anchored our local financial institution’s inertia to recognizing and accepting this mode of security interest. Our Micro, Small and Medium Enterprises (MSMEs) remain the worst hit by this circumstance. Given the volatility of their businesses and the high credit risks that same portends to lenders they are often subjected to high interest rate lendings and very strict collateral requirement.

The Central Bank of Nigeria in a bid to stimulate access to finance by MSMEs had in September 2014 introduced the Central Collateral Registry Regulations; the regulation amongst other things was expected to:

 encourage financial institutions to accept movable assets as security for loans granted;
 provide a framework for the establishment of a national collateral registry;
 establish the process of registration and the realization of security interests over movable property;
 Stimulate responsible lending to MSMEs.

BILL OF SALE AND CREATION OF SECURITY INTERESTS IN MOVABLE PROPERTY

The Bill of Sale Act, 1882 was introduced in England to regulate the assignment, transfer and mortgage of movable properties. The subsequent amendments to the Act saw the parliament making efforts to protect creditors and mortgagees1 who had been granted a security interest in movable property by way of a Bill of Sale.2 The laws recognized these creditors/mortgagees as the True Owner of the movable property in spite of the retention of possession by the mortgagor/Obligor provided that the Bill of Sale creating the security interest was registered3. The True Sale4 status granted to the beneficiary of the Bill of Sale gave them further protection in the event of the liquidation (or bankruptcy in the case of an individual) of the mortgagor in which case the movable property became bankruptcy remote and inaccessible to the other creditors of the mortgagor.

The Bill of Sale Act of 1873 and 1882 form part of the Statute of General Application5 under the Nigerian Law. Given that Bill of Sale transactions fall within the legislative competence of the State Governments of Nigeria the Act is only applicable to the extent that individual States have adopted

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1 i.e. persons who had taken collateral in movable property to secure the obligations of its owners.
2 any written instrument showing the voluntary transfer of a right or interest or title to personal property
3 registration of the bill gave the Mortgagee priority over subsequent creditors or purchasers of the property.
4 a transaction which gives one party a legal interest in an asset.
5 Laws of England in force before 1st of January 1900, which are by extension applicable in Nigeria.
them. To date only Lagos, Oyo, Ogun, Ondo, Osun, Ekiti, Edo and Delta States have adopted these laws and on the back same established the Bill of Sale registries in their respective states.

The failure of the other States to adopt the law has hampered the utilization of movable property as security. It is to this end that the Governor of the Central Bank of Nigeria under his inherent powers to make regulations in relation to the operation and control of institutions under his supervision has issued the Regulation which from the date of its issue becomes binding and applicable to all Financial Institutions in Nigeria.

THRU OF THE REGULATION

A. SCOPE

The regulation applies to all security interests in movable property created by an agreement that secures a payment or the performance of an obligation (irrespective of the form of the transaction, the type of movable property securing such obligation or the nature of the secured obligation). The regulation does not however apply to any agreement between parties relating to a set-off, a charge registrable under the Companies and Allied Matters Act, the creation or transfer of interest in land, right of payment in connection to an interest in land or a transfer of interest in other movable property for which a registry has by law been created.

A security interest in a movable property is required to be created by contract (“Security Agreement”) which shall be enforceable in accordance with its terms and enforceable without recourse to the Obligor once same is registered at the collateral registry which is administered by a registrar appointed by the CBN.

B. REALIZATION OF SECURITY INTERESTS

i. Enforcement: Any holder of a registered security interest; shall have the right to enforce such interest (in addition to any other judicial remedy at its disposal) in accordance with the Security Agreement after such right has become exercisable and upon serving a notice of default on the Obligor. From the receipt of the notice of default the Obligor shall have 10 days to make good his obligations failing which the Secured Creditor shall have the right (pursuant to a judicial process or an agreement to enforce the security interest without a court order) to:

- take possession of the collateral; or
- render the collateral inoperative, if it is of a kind that cannot be readily moved from the Obligor's premises or is of a kind for which adequate storage facilities are not readily available;
- dispose of the assets, whether within the Obligor's premises or otherwise (provided that the other occupants of the premises will not suffer any inconvenience on account of the disposal);

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7 Debt secured by collateral to reduce the risk associated with lending.
8 The right of a creditor to recover payment from monies due to the debtor and over which he has direct control.
9 Such as ships and aircrafts.
collect and apply cash, negotiable instruments or account receivables taken as collateral in satisfaction of the amount owed.

Where a Secured Creditor intends to exercise his right to sell the collateral; it must first issue a notice of not less than 10 days to the Obligor and other secured creditors of its intention to sell (such notice will not be required where the collateral is perishable or may diminish in substantial value during the requisite notice period). Any such sale automatically extinguishes the security interest of other secured creditors.

In any case the Secured Creditor shall within 15 (fifteen) days following the sale provide to all parties entitled to receive notice of sale, a statement of account detailing:

- the sale value
- cost and expense of sale
- total owing to secured creditor and any balances accruing from sale proceeds.

Any surplus realized from the sale shall be distributed first to other secured creditors (in order of their priority) and finally to the Obligor.

ii. **Redemption:** Where the Obligor is in default and the Secured Creditor has given a notice of intention to sell/realize the collateral; the Obligor may still redeem the collateral or reinstate the security agreement by taking steps to fulfil any obligation(s) which have become due (including expenses incurred by the Secured Creditor in relation to the sale) any time before the sale is executed.

iii. **Cancellation:** Upon full satisfaction of the Obligor’s secured obligation the Obligor shall make demand for cancellation of the Security Interest. The Secured Creditor shall, within 15 (fifteen) working days from the receipt of such notice, register a cancellation statement in the manner prescribed in the regulation. Where a Secured Creditor has an objection to the cancellation demand, he shall respond within 7 (seven) days of receipt of the notice.

Where the secured creditor fails to effect the cancellation, the Obligor may appeal to the Registrar showing cause as to why the registration should be cancelled by the Registrar. The Registrar’s decision on this request shall be final subject to a right to appeal to a Court of competent jurisdiction.

iv. **Priority between security interests:** In the event of default, winding up, liquidation or bankruptcy of the Obligor, registration at the registry affords the secured creditor priority in realization of the debt. Where there are two registered interests in the same collateral, priority will be determined by the order of registration or possession whichever happens first.

It is instructive to note that the Regulation preserves the right of a bonafide purchaser or lessee who purchases or leases goods in the ordinary course of business.

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10 Any creditor who has registered its interest over the collateral (by way of a financing statement) in the collateral registry.
11 The debtor makes good his default during the contract period thereby allowing parties to fall back into the contract.
C. IMPACT OF THE REGULATIONS ON THE FINANCING SECTOR

The introduction of the regulation by CBN is commendable and has the capacity to deepen the financing sector. Amongst other things, the Regulation like the Bill of Sale Act will create a wider pool of assets that can be utilized as collateral for loans or other obligations required to be collateralized. MSMEs can now use movable properties such as machineries, vehicles, furniture, negotiable instruments and stock in trade as collateral to secure loans sourced from financial institutions. The availability of more funds to this sector will without doubt enhance the liquidity of the real sector of the Nigerian economy and invariably the Gross Domestic Product (GDP) of the Country.

The Regulation also enhances the loan origination capacity of financial institutions having sanctioned a wider pool of acceptable collateral.

In addition to guaranteeing a wider pool of collateral, the Regulation also provides protection for Obligors and their collateralized assets by providing clear rules for the creation and realization of security.

D. ISSUES WITH THE REGULATION

Inspite of the desirability of the Regulation the practicability of its implementation could hamper its objective of stimulating growth in credit advancement to MSMEs. To this end, the CBN will need to take decisive steps to address the shortcomings in the regulations.

A firm engagement with the State Governments will be desired as there is need to adopt a more robust legal framework through the adoption of the already existing Sale of Goods Law and the enforcement powers which only resides in the of the executive arm of Government. The backing of the judiciary will also be required for the prompt determination of disputes arising in respect of registered security interests.

Another pertinent issue is the adoption of the electronic registry system. Given the inherent challenges of data administration and retrieval that is synonymous with other electronic registry systems in the Country; where the registration systems and processes are not full proof, financial institutions will lose confidence in the system.

The CBN must also consider the use of different registration platforms for different classes of assets (each homogeneous pool should have its own sub – registry for ease of data management and recovery).

CONCLUSION

The CBN has shown innovation and good intention with the adoption of the Collateral Registry Regulation and there is no doubt that the introduction of the regulation has the capacity to bolster access to finance by individuals and MSMEs. That being said, the success of this venture will be strongly dependent on CBNs ability to engage with other stakeholders that have the capacity to support and influence the implementation and enforcement of the commercial principles of the regulation.