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Factoring Model Law Working Group

First session (remote)
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SUMMARY REPORT

OF THE FIRST SESSION

(Videoconference, 1 – 3 July 2020)

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1. The first session of the Working Group to prepare a Model Law on Factoring (hereafter the "Working Group") took place via videoconference between 1 and 3 July 2020. The Working Group was attended by 32 participants, comprising of (i) 9 Working Group Members, (ii) 18 observers from six international, regional and intergovernmental organisations, four industry associations and academia and (iii) 5 members of the UNIDROIT Secretariat (the List of Participants is available in Annex II).

Item 1: Opening of the meeting by the Chair

2. The Chair of the Working Group and Member of the UNIDROIT Governing Council *Mr Henry Gabriel* (hereafter the "Chair") welcomed all participants to the first session. He noted that the development of the Model Law on Factoring (hereafter the "MLF") had been approved by the UNIDROIT Governing Council at its 98th session in May 2019 as a high priority project on the Institute's 2020-2022 Triennial Work Programme.

3. *The Chair declared the session open.*

Item 2: Adoption of the agenda and organisation of the session

4. *The Working Group adopted the draft Agenda (UNIDROIT 2020 – Study LVIII A – W.G.1 – Doc. 1, available in Annex I).*

Item 3: Consideration of matters identified in Issues Paper (Study LVIII A – W.G.1 – Doc. 2)

(a) Preliminary matters

5. The *Chair* explained the origin of the MLF project with reference to the proposal submitted by the World Bank to the Governing Council in December 2018. He explained that the purpose of the MLF was to provide an instrument for States that wanted to introduce a new factoring law or update their existing laws but were not yet in a position to undertake a comprehensive secured transactions law reform.

6. The Chair noted that the development of the MLF would need to take account of relevant existing international instruments, including the *1988 UNIDROIT Convention on International Factoring* (hereafter the "Factoring Convention"), the *2001 Convention on the Assignment of Receivables in International Trade* (hereafter the "Receivables Convention") and the *2016 UNCITRAL Model Law on Secured Transactions* (hereafter the "Secured Transactions Model Law"). He further explained that both Factors Chain International (FCI) and AFREXIMBANK had prepared Model Laws on Factoring in 2014 and 2016 respectively, and that a number of other relevant instruments were set out in Annex I of *UNIDROIT 2020 – Study LVIII A – W.G.1 – Doc. 2* (hereafter "Doc. 2").

7. With reference to paragraphs 8-9 of Doc. 2, the Chair explained that the MLF would consist of a set of black letter rules, accompanied by a limited commentary on each rule to explain its operation. He suggested that the Working Group use the *Standard Definitions for Techniques of Supply Chain Finance* (SCF) as adopted by the Global Supply Chain Finance Forum. He noted that there were other terminology issues associated with the differing terminology used in the Factoring Convention, Receivables Convention and Secured Transactions Model Law but suggested that the discussion on the terminology used in the MLF itself be deferred. He suggested that the discussion

on the formal title of the instrument also be deferred until the Working Group had discussed the scope of the instrument.

8. The Chair thanked the Kozolchyk National Law Center (hereafter “NatLaw”) for assisting the UNIDROIT Secretariat in preparing the documents for the Working Group and invited NatLaw to introduce an industry survey it had recently undertaken.

9. *Mr Marek Dubovec (NatLaw)* explained that NatLaw had contacted the largest factoring industry associations and asked them a number of questions relating to the legal issues that present an impediment to or increase in the cost of factoring.[1] He noted that the main legal issues reported by the industry related to perfection requirements, anti-assignment clauses, preferential treatment for certain parties, enforcement and costs. The industry reported that most factors utilised absolute assignments of receivables but also undertook asset-based lending and in some cases a blended approach. The industry preferred absolute assignments (sales) rather than taking security interests over receivables as absolute assignments tended to provide better protection for the factor in the case of the assignor’s bankruptcy. The industry undertook factoring without recourse, with limited recourse and full resource factoring, although majority of factoring was undertaken without recourse. The industry reported that consumer receivables were financed only exceptionally and there were several categories of receivables that the industry tended not to purchase/finance. He concluded that Natlaw would continue to engage with industry to expand the detail and scope of the questionnaire and report back to the Working Group with further information at its second session.

10. *Ms Louise Gullifer* asked whether industry had provided any information or statistics regarding notification and non-notification factoring? *Mr Dubovec* responded that the initial survey had not addressed the issue but it could be included in subsequent consultations.

(b) Scope of the Model Law

i. Types of receivables to be covered

11. With reference to paragraphs 46 – 51 of Doc. 2, the *Chair* opened the floor for remarks regarding the types of receivables that should fall within the scope of the MLF.

12. *Mr Ulrich Brink (FCI)* explained that in negotiating the Receivables Convention it had not been possible to agree on a definition for “trade receivable”. He suggested that the Working Group approach the scope of the MLF by considering all possible receivables that could be financed and progressively restrict the scope as necessary. He raised three issues: (i) whether the MLF should only apply to contractual receivables or whether it should also apply to receivables arising from non-contractual obligations, such as tort receivables; (ii) he recommended that the MLF apply to consumer receivables on the basis that credit card receivables would be appropriate for coverage by the MLF; and (iii) he recommended that the MLF should broadly apply to different types of supply chain finance.

13. *Mr Ignacio Tirado (UNIDROIT)* queried whether it would be useful for the industry if the MLF had a wider scope that included non-contractual receivables, such as tort claims that arose from judicial decisions. He further asked whether there was a significant financing industry in non-

[1] The NatLaw survey asked five questions: (i) What are the top three legal issues that present an impediment to or increase the cost of factoring?; (ii) Do your members take security interests in receivables, or absolute assignments only?; (iii) Do your members’ factoring transactions usually include some recourse against the assignor, and, if so, can you provide examples of the types of recourse?; (iv) Do your members purchase/finance receivables owed by consumers?; (v) Which types of receivables your members do not purchase/finance at all?

contractual receivables and whether it was necessary for the MLF to cover them in order to facilitate finance and trade.

14. *Ms Louise Gullifer* noted that the Receivables Convention did not apply to non-contractual payments such as tort claims and tax refunds and also did not apply to other types of payments such as foreign exchange transactions, bank deposits and letters of credit.

15. *Mr Neil Cohen* suggested that the Working Group should adopt a pragmatic approach rather than a conceptual approach to defining the scope of the MLF which focused on the need for rules to facilitate financing. He agreed that the Working Group should begin with the temporary assumption that the MLF should have a broad scope and then consider excluding particular types of receivables that would require the MLF to include a prohibitive number of specialised rules governing that particular type of receivable. He noted that this approach was adopted by the Receivables Convention, which has a relatively broad general scope in relation to receivables and then subsequently excluded certain types of transactions in Article 4. In relation to tort receivables, he suggested that it might be best to exclude them from the scope of the MLF on the basis that it might require a number of specialised rules and would raise challenging policy issues, such as whether a party would have the right to assign tort receivables related to damages for pain and suffering.

16. *Ms Catherine Walsh* agreed that the Working Group should start with an assumption that the MLF should have a broad scope including tort receivables and then gradually refine it. In relation to receivables arising from a contractual agreement, she suggested that receivables arising from bank accounts and financial market transactions should be excluded.

17. *Mr Peter Mulroy (FCI)* noted that in relation to non-contractual receivables, he was aware of receivables related to value-added taxes (VAT) claims being factored in central and eastern Europe. He explained that the FCI did not promote the factoring of receivables outside the normal trade terms. He further explained the FCI was careful to promote and educate its members of the risks outside the factoring of trade receivables and noted that fraud posed a higher risk when factoring VAT related receivables.

18. *Mr Alejandro Garro* also agreed that the Working Group should begin with a broad conception of the scope of the MLF in relation to contractual receivables and then identify necessary exceptions. He suggested that a reasonable starting point might be for the MLF to apply to a contractual right to the payment of a monetary sum.

19. *Mr Ignacio Tirado (UNIDROIT)* queried the exact meaning of “non-contractual receivables”. He asked whether this term included contractual claims determined by a judge following litigation and whether it would be desirable for the MLF to apply to such receivables. Mr Tirado further cautioned that receivables related to tax claims were complicated and that in many States tax refund claims were only used to offset future earnings and could not be legally assigned.

20. *Mr Ulrich Brink (FCI)* agreed with Mr Mulroy that the factoring community was generally only concerned with contractual receivables. He suggested that the Working Group consider starting with the “contractual right to payment of a monetary sum” set out in Article 2 of the Receivables Convention. He suggested that the Working Group should consider whether rights to payment arising from judgments of contractual claims and payments arising from tort judgments should also be within the scope of the MLF. He also agreed that receivables related to tax claims were problematic as they could only be assigned in certain States under specific conditions.

21. *Mr Jin Saibo (FCI)* noted the new Chinese Civil Code did not set a limitation on the scope of receivables to which it applied. He further explained that High Court of Shanghai had decided that there were some limitations in relation to the factoring of consumer-related receivables and the main

problem in China was rights to payment in the form of negotiable instruments. He concluded that the MLF should have a broad scope and should only exclude certain types of receivables on an exceptional basis.

22. *Mr John Wilson (IFC)* agreed that the scope of the MLF should be targeted to receivables arising from contractual relationships. He suggested that even if the MLF covered only contractual receivables, it would still have a broad scope in applying to the many variations of trade receivables. He noted that if the instrument were also to cover non-contractual receivables, additional complexities would arise, especially in civil law States. He explained that from the World Bank Group standpoint, the focus of the MLF should be commercial contractual relationships. He suggested that receivables arising from tax claims and tort claims related generally related to consumers or private individuals rather than business entities. He suggested that if consumer receivables were to be excluded from the scope of the MLF, it would be logical to also exclude certain types of non-contractual receivables that generally relate to individuals rather than businesses.

23. *Mr Erik Timmermans (WOA)* confirmed that the majority of receivables factored were contractual receivables and trade receivables. He noted that in Germany and the United States insurance companies also factored receivables related to medical claims. Mr Timmermans suggested the Working Group might wish to consider whether such receivables should fall within the scope of the instrument.

24. *Mr Neil Cohen* suggested that two further clarifications were necessary in relation to the application of the MLF to contractual receivables. First, he queried whether the MLF would also apply to contractual rights to the payment of money where the promise to pay was not denominated in a sovereign currency. Second, he asked whether the MLF would apply only to enforcing contractual rights to payment or whether it would also apply to monetary claims arising out of contract law, such as for breach of contract. He suggested that applying the MLF to the monetary claims arising out of contract breaches might raise additional complications.

25. *Ms Louise Gullifer* raised two further scope issues that would require further clarification. First, she asked whether the MLF would apply to litigation finance, which would cover contractual rights to damages. Second, she queried whether the MLF would apply to the securitisation industry, noting that any financial claim such as credit card claims could be securitised.

26. *Mr Marek Dubovec (NatLaw)* suggested that in deciding whether the MLF should have a narrower or broader scope the Working Group should consider the purpose of the instrument in assisting States in transitioning towards a comprehensive secured transactions law reform. He noted that in many States, central banks were the major stakeholders in receivables law reform and tended to focus on trade finance, authorising and licencing entities. He suggested that it might be useful for the MLF to apply to non-contractual receivables because it might assist States wanting to reform this area of law. Regarding securitisation, he noted that the Receivables Convention dealt with securitisation whereas the Factoring Convention had a narrower scope. Finally, he noted that certain rules would need to be altered if a broader scope was adopted. He gave the example of the treatment of anti-assignment clauses which were relevant for trade receivables but would raise different issues for a broader subset of receivables. *Mr Brink* agreed with Mr Dubovec and reflected that even limiting the scope of the MLF to contractual receivables still raised a number of complicated issues.

27. *Mr Richard Kohn* (SFN) recommended that the MLF should accommodate recent industry innovations such as receivables financing platforms and reverse factoring. He noted that while future innovations could not be predicted, it would be sensible to define the scope of the instrument flexibly so it could cover new forms of factoring or financing that might emerge in the future.

28. *The Chair summarised the discussion. From a methodological perspective, he noted that the Working Group had agreed to start with an assumption that the MLF should have a broad scope which would be gradually narrowed down. It was agreed that the instrument should apply to contractual rights to payment, although the exact meaning of "contractual rights" needed further consideration. He noted that a range of other scope issues related to tort receivables, tax receivables, medical receivables, payments in non-sovereign currencies, litigation finance and securitisation had been raised, and the Working Group was not yet in a position to make firm decisions on these issues at the first session. He concluded that the scope of the instrument should be flexible enough to accommodate future innovation.*

ii. Application to negotiable instruments

29. *The Chair* introduced the topic. He noted that in compliance with the Working Group's general assumption that the instrument should have a broad scope, it would need to decide whether the MLF would apply to negotiable instruments. He opened the floor for comments.

30. *Mr Ulrich Brink* noted that under traditional factoring practices, invoices were in written form and transmitted by mail to the debtor and then subsequently to the factor for purchase. He explained that practices had changed over time and that credit notes and electronic invoices were now the norm. In relation to negotiable instruments, he noted that they were usually governed by a different law which might raise some challenges if they were included within the scope of the MLF.

31. *Mr John Wilson (IFC)* explained that while in most jurisdictions negotiable instruments were excluded from specific laws regulating factoring, in some Latin American jurisdictions factoring was almost exclusively undertaken using negotiable instruments. In Argentina, factoring was often done using a post-dated cheque, a method favoured by banks as it allowed them to have the receivable and payment instrument in the same document. In Brazil, factoring was often undertaken using a "duplicata", which was a physical carbon copy of the receivable treated as a negotiable instrument. He explained that electronic "duplicatas" were now traded on electronic platforms in Brazil. He noted that in Peru and Chile, once a debtor had confirmed they were able to pay an invoice, the invoice became a negotiable instrument by force of law. He further explained that in other jurisdictions negotiable instruments in the form of promissory notes or IOUs were uploaded to reverse factoring platforms. Reflecting on these various practices, he recommended that the Working Group consider widening the scope of the MLF to apply to negotiable instruments in order to make the law attractive in Latin America and other jurisdictions that rely on negotiable instruments as a key aspect of receivables finance. *Marek Dubovec (NatLaw)* agreed that in Latin America the concept of a credit claim (a right to payment) included negotiable instruments as well as invoices.

32. *Mr Ammar al-Saleh (EBRD)* agreed with Mr Wilson. He noted that in the Balkans region and the Middle East it was becoming increasingly common for receivables finance to be based on documentation (both electronic and written) other than invoices that in some cases were negotiable instruments under the relevant law.

33. *Mr Neil Cohen* suggested that while negotiable instruments played a major role in international commerce, the main issue for the Working Group to consider was whether their inclusion in the MLF would require the addition of a large number of specialised rules. He explained that the treatment of negotiable instruments in the Secured Transactions Model Law and the Receivables Convention were slightly different. Article 4(3) of the Receivables Convention provided that "*nothing in this Convention affects the rights and obligations of any person under the law governing negotiable instruments*". He explained that this had been a challenging article to agree upon during the negotiation of the Receivables Convention. Article 2(dd) of the Secured Transactions Model Law defined "receivable" as "*a right to payment of a monetary obligation, excluding a right to payment evidenced by a negotiable instrument*". He suggested that the Working Group should take

note of UNCITRAL's experience in this area and adopt the approach of the Receivables Convention and Secured Transactions Model Law in excluding negotiable instruments from the definition of a receivable.

34. *Mr Alejandro Garro* suggested that notwithstanding the challenges associated with negotiable instruments, the MLF should provide guidance to States that already utilised negotiable instruments as a common form of receivables finance. He noted that the MLF would not need to suggest that all States should have their factoring law apply to negotiable instruments, but the MLF should provide guidance to those States that wanted to include negotiable instruments. He concluded that such an approach would ensure the instrument would be widely acceptable and would leave it to enacting States to decide exactly what parts should be included or excluded.

35. *Mr Bruce Whittaker* noted that his initial instinct had been to exclude negotiable instruments from the scope of the MLF, although he needed to give the issue further consideration in light of the use of negotiable instruments in Latin America, the Balkans and the Middle East. He noted that the meaning of "negotiable instrument" would vary between States, and it would be for the domestic law to give meaning to the expression. He queried whether it was anticipated that the MLF would provide for optional or alternative provisions. He noted that such an approach might be useful for the treatment of negotiable instruments and consumer receivables.

36. *The Chair* noted that there might be value in the MLF providing some alternative provisions to make the instrument as attractive as possible to different States, although there was no need for it to accommodate all existing practices. He suggested that the Working Group defer discussion on this issue until a later time.

37. *Mr Ulrich Brink* reminded the Working Group that there were special laws regulating bills of exchange and cheques which provided that they needed to be in certain forms to be valid. He further explained that the defences related to bills of exchange tended to be quite limited, whereas the MLF should allow the debtor to have all defences against the factor that the debtor would have had against the original creditor. He also noted that priority was resolved differently for bills of exchange and cheques. He suggested that the MLF should adopt the Receivables Convention approach in preserving the specialised laws applying to bills of exchange and cheques and include language to the effect of "*nothing in this Convention affects the rights and obligations of any person under the law governing bills of exchange and cheques*". *The Chair* agreed that the MLF was likely to have limited form requirements and that form requirements would necessarily be different for negotiable instruments.

38. *Mr Steven Geerlings (WOA)* agreed with Mr Brink in relation to formal requirements. He suggested that if the MLF was to adopt a broad scope it would need to defer to local law on issues such as format, otherwise the instrument would have to provide lots of specific rules on each type of receivable.

39. *Mr Peter Mulroy (FCI)* agreed with Mr Wilson that in many States the use of negotiable instruments in factoring was common. He explained that in many emerging markets the first step towards developing factoring markets was to develop "chequering". He noted that even in certain mature markets negotiable instruments were also used in relation to receivables finance.

40. *Mr Edward Wilde (FCI)* noted that a post-dated cheque should be treated as the instrument of payment for a receivable rather than the receivable itself.

41. *Mr John Wilson (IFC)* explained that the common law notion of receivables didn't really exist in Latin America. He agreed that the Secured Transactions Model Law appropriately excluded negotiable instruments from receivables because their inclusion would have caused issues for holders in due course. He explained that the World Bank Group had faced challenges in implementing the

Secured Transactions Model Law in Latin America, especially in Peru and Colombia where receivables were generated from the sale of inventory, and invoices were treated as negotiable instruments. In these States, asset-based lending was not possible because invoices could be sold to third parties other than the asset-based lender. He concluded that it was necessary for the MLF to have a more targeted scope and specialised rules as compared to the Secured Transactions Model Law and recommended against a blanket exclusion of negotiable instruments from the scope of the MLF.

42. *Mr Michel Deschamps* suggested that the MLF should adopt the approach of the Receivables Convention in limiting its scope in relation to negotiable instruments. He suggested that the Working Group deferred its discussion on exclusions until it had discussed other substantive provisions.

43. *Mr Jin Saibo (FCI)* noted that in China it was quite common for negotiable instruments to be used in the factoring transactions and that invoices were considered to be negotiable instruments. However, he explained that problems had arisen from regulations that required licencing for companies that engaged in negotiable instrument discounting.

44. *Mr Marek Dubovec (NatLaw)* suggested that negotiable instruments should be included within the scope of the MLF if their inclusion would increase access to credit. He noted that any benefits of including negotiable instruments would need to be balanced against any harm that their inclusion would cause. He further suggested that one benefit of including negotiable instruments was in relation to priority and perfection. He explained that perfection through registration would reduce costs for parties, a holder in due course could still prevail and there would be protection from registration in bankruptcy.

45. *Mr Giuliano Castellano* noted that, from a regulatory standpoint, a post-dated cheque might be treated differently under accounting standards. He noted that inclusion of certain types of negotiable instruments in the MLF might have unintended consequences if there were different reporting requirements.

46. *Ms Megumi Hara* agreed with Mr Deschamps that the MLF should start with a general approach to defining receivable and consider the inclusion of negotiable instruments at a later point. She noted that a reform of the Civil Code had been implemented in Japan in April 2020 which included provisions on negotiable instruments. She explained that the new law included four types of negotiable instruments, including promissory note and bill of exchange, which applied rules as necessitating endorsement and/or possession of the instrument for transfer, as well as rule on the bona fide acquisition. She noted that the usage of bills of exchange in Japan was decreasing and are potentially being replaced with practices more closely aligned to factoring of receivables by means of electronically recorded receivables.

47. *Mr Neil Cohen* agreed with Mr Deschamps that, as a matter of process, the Working Group should start with a general rule excluding negotiable instruments and then different types of negotiable instruments should be considered for inclusion on the basis of whether the MLF rules would have to be changed for that particular negotiable instrument. He suggested that negotiable instruments could not be treated as a unified monolithic concept, as rules regarding bills of exchange and cheques operated differently from those governing promissory notes. He noted that negotiable instruments could have different rules in relation to form, conditions, defences and freedoms for property claims and that all of these differences would need to be taken into account in deciding whether certain types of negotiable instruments should be included in the scope of the MLF.

48. *Mr Ignacio Tirado (UNIDROIT)* noted that it was important to listen carefully to the experiences of the World Bank Group and EBRD in implementing secured transactions and factoring reforms around the world. He suggested that any decision to exclude certain matters that would decrease the attractiveness of the MLF in different regions would need to be considered carefully by the Working Group.

49. *The Chair summarised the discussion. The Working Group agreed that negotiable instruments could not be considered to be a unified concept and would have many different laws regulating them. The Working Group further agreed that the inclusion of different types of negotiable instruments in the MLF should be considered on a case-by-case basis. The Working Group was not yet in a position to make a decision in relation to the treatment of different types of negotiable instruments in the MLF.*

iii. Assignment of receivables for collection only

50. *The Chair* introduced the topic and opened the floor for comments.

51. *Ms Louise Gullifer* supported the exclusion of the assignment of receivables for collection only and for the sale of a business. She explained that it would be better to explicitly exclude these types of transfer rather than defining the scope of the MLF with reference to the assignment of receivables for "financing purposes" which would create further complexities. She concluded that there might be other types of receivables that should also be explicitly excluded from the scope of the law.

52. *Mr Bruce Whittaker* noted that any possible exclusion should be limited to the transfer of a receivable to a debt collector for affiliated services.

53. *Mr Edward Wilde (FCI)* queried whether there would be any harm in including collection agreements within the scope of the MLF. He noted that collection assignments might be to factors in another State rather than debt collectors. He explained that there was an FCI product which provided a collection only facility, under which an exporter in one State assigned the receivable to a factor in that State and then the factor subsequently assigned the receivable to a factor in the debtor's State. He also noted that sometimes collection was undertaken by appointing the factor in the debtor's country as an agent.

54. *Mr Peter Mulroy (FCI)* noted that in 2019 collection only assignments generated only 1% of the total volume of worldwide factoring. He explained that in most cases collection only assignments were used in assigning receivables to a third party which tended to be either a factor in the debtor's State or for legal collection. He concluded that while it formed a small party of the overall factoring landscape, it was a part of existing practices.

55. *Ms Catherine Walsh* noted that any exclusion in relation to collection only assignments should not exclude the application of the rules in the MLF between the assignee and the account debtor. Instead, the exclusion of collection only assignments should apply to the MLF perfection and priority rules. She concluded that at this point she favoured the MLF not broadly excluding collection only assignments, although she noted that it might be challenging to craft a sufficiently refined rule to exclude only parts of the law in relation to these types of assignments.

56. *The Chair summarised the discussion. The Working Group decided not to broadly exclude the assignment of receivables for collection only from the MLF, although certain aspects of the instrument might not be appropriate for these types of assignments. The Working Group concluded that the issue would require further consideration.*

iv. Assignment of receivables for the sale of a business

57. *The Chair* introduced the topic, noting that receivables in connection with the sale or transfer of a business were normally excluded from these types of instruments because they did not relate to financing.

58. *Ms Louise Gullifer* said that the assignment of such receivables should be excluded from the MLF. She suggested that the exclusion should be drafted widely enough to ensure it covered all receivables associated with the sale of the business (for example, the transfer of a business property).

59. *Mr Steven Geerlings (WOA)* suggested that if there was a finance element in the sale of the business then the transaction should not necessarily be completely excluded from the scope of the MLF.

60. *Mr Michel Deschamps* noted that receivables connected to the transfer of a rental property was another example of an assignment that should be excluded from the MLF.

61. *Mr Neil Cohen* noted that while there appeared to be agreement on the policy position that the MLF should only apply to financing transactions, the rule implementing this policy decision would be imperfect when written. He suggested at this stage in the process achieving a clear policy line was more important than trying to draft a perfect rule.

62. *Mr Ignacio Tirado (UNIDROIT)* reaffirmed that the purpose of the project was to prepare a model instrument for factoring, not for the assignment of claims or receivables. He urged the Working Group to focus on its core mandate and suggested that transfers of receivables as part of the sale of a business and the transfer of its assets were not sufficiently connected to factoring to warrant inclusion in the MLF.

63. *Ms Megumi Hara* agreed with Mr Tirado on the importance of a clear division between the transfer of commercial receivables and other types of transfers. She suggested that both the transfer of a business and succession should be outside the scope of the MLF. She queried whether the transfer of a contract right itself would be excluded from the instrument. *The Chair* responded that the transfer of a contract right itself was not necessarily related to factoring or financing.

64. *Ms Catherine Walsh* noted that the MLF commentary should clarify that the rules governing the relationship between assignor and assignee and account debtor in the MLF should diverge from the normal assignment rules in the enacting State, otherwise the MLF would create characterisation issues for that State.

65. *Marek Dubovec (NatLaw)* noted that the approach to exclusions being contemplated by the Working Group reflected the Receivables Convention approach of adopting a broad scope with a range of exceptions as opposed to the Factoring Convention approach of adopting a narrow scope.

66. *The Chair confirmed that the Working Group decided to exclude assignments related to the sale of a business from the scope of the MLF.*

v. Outright transfers and security interests

67. *The Chair* introduced the topic with reference to paragraphs 52 – 55 of Doc. 2.

68. *Mr Ulrich Brink* suggested that the MLF should obviously apply to the transfer of full ownership of a receivable. He noted that there was another type of transfer under French law where the transfer was achieved through payment to a third party and a subsequent transfer of the receivable to the payor. He suggested that these types of full transfers should also fall within the scope of the instrument. In relation to security interests, he suggested that they should also be included within the scope of the MLF on the basis that in some States pledges or other security interests were used by factors, thereby making the factor the holder of a security interest rather than a full owner. He

concluded that the MLF would need to cover both outright transfers and security interests to ensure that priority issues could be resolved.

69. *Mr Orkun Akseli (observer)* agreed that the instrument should apply to outright transfers. He suggested that security interests should not be included within the scope of the MLF on the basis that it would create an undesirable overlap with the Secured Transactions Model Law.

70. *Mr Bruce Whittaker* agreed with Mr Brink that the instrument needed to cover both outright transfers and security interests in order to resolve priority conflicts. He noted that the priority rules would be incomplete if they only applied to priority conflicts between outright transfers but not to security interests.

71. *Mr Michel Deschamps* noted that it was not always easy to determine whether an assignment was categorised as an outright assignment or security assignment and that security interests should be included within the scope of the MLF.

72. *Mr Marek Dubovec (NatLaw)* suggested that the MLF should have a dual purpose of (i) assisting States in their transition towards a comprehensive secured transactions reform and (ii) providing additional rules to other States that had recently undertaken secured transaction reforms that were incomplete. In achieving these purposes, he noted that it would preferable for the instrument to apply to both outright transfers and security interests. He noted that the Secured Transactions Model Law applied to both outright transfers as well as transfers that create security interests, so there would be unavoidable overlap between the MLF and the Secured Transactions Model Law regardless of whether the MLF applied to security interests.

73. *Mr Neil Cohen* noted that it was important for the MLF to follow the UNCITRAL policy of taking a functional approach to determining the difference between an outright transfer and a security assignment. He noted that where transfers included recourse arrangements, the line between outright transfers and security assignments was less clear. He noted that there were strong economic and policy reasons for including both outright transfers and security assignments within the scope of the instrument. He suggested that transfers involving third parties paying the debt as identified by My Brink should be discussed in more detail at a later point.

74. *Mr Peter Mulroy (FCI)* agreed that the MLF should apply to both outright transfers and security assignments. He noted that the resolution of priority conflicts was one of the main benefits of the instrument. However, he suggested that the inclusion of security interests would raise additional complications and have accounting implications. He concluded that while the Working Group had not yet made a decision on the title of the instrument, it could not be called the “Model Law on Factoring” if security interests were included in the scope.

75. *Mr Murat Sultanov (IFC)* agreed with the inclusion of both outright transfers and security assignments within the scope of the MLF. He suggested that the MLF should borrow principles directly from the Secured Transactions Model Law. He noted that in preparing the UNIDROIT Model Law on Leasing, there had been discussion as to whether the instrument should apply to only financial leases or also general leases. It had been concluded that the Model Law on Leasing should apply to both and that enacting States could choose whether to limit its scope to only financial leases. *The Chair* agreed that the MLF could borrow heavily from the Secured Transactions Model Law on many matters.

76. *Mr Edward Wilde (FCI)* supported the inclusion of both outright transfers and security interests within the scope of the instrument, noting that in some States factoring was mainly done through security assignments. He noted that in the FCI rules, the assignment in security was treated

the same as assignment by way of purchase. He further noted that in order for the instrument to increase the availability of finance in Africa it would need to apply to security interests.

77. *Ms Louise Gullifer* agreed that the assignment of security interests needed to be included within the scope of the MLF. However, she noted that in many common law States, financiers took security over everything owned by a debtor by way of a floating charge. She queried whether the instrument would apply only to the receivables financing portion of a floating charge, but not over the broader security interest. *The Chair* noted that this matter would require further consideration.

78. *Mr Orkun Akseli (observer)* agreed with Ms Gullifer that the full outcomes of applying the MLF to the security assignment would need to be considered carefully. He suggested that it would lead to complicated outcomes and again suggested that the instrument should apply only to outright transfers.

79. *Mr Jin Saibo (IFC)* noted that the Chinese Civil Code allowed pledges of receivables. He noted that the new Civil Code included several articles regulating the transfer and assignment of receivables under a specific contract. Finally, he explained that China was considering the future establishment of a national uniform law for security interests, which would provide entirely new rules for third party effectiveness.

80. *Mr Richard Kohn (SFN)* agreed that the MLF should apply to both outright transfers and security assignments. He noted that if the instrument did not apply to the security assignment, it would be very problematic if an outright transfer was recharacterised as a security assignment due to the contract's recourse provision and thus was excluded from the scope of the law.

81. *The Working Group agreed that the MLF should apply to both outright transfers and security assignments. The Chair noted that this approach raised a number of issues that could be addressed by borrowing rules from the Secured Transactions Model Law.*

vi. Recourse

82. *The Chair* opened the floor for comments regarding the MLF approach to recourse. He asked the Working Group whether the MLF should explicitly distinguish between recourse and non-recourse factoring.

83. *Mr Chris Wolhert (APEC IFDN)* noted that it was common for factoring contracts to have a hybrid structure that include partial recourse and there was not a clear cut line between recourse factoring and non-recourse factoring.

84. *Mr Michel Deschamps* noted that as the Working Group had agreed that the MLF should apply to security assignments, it should also apply to outright transfers with recourse.

85. *Mr Ulrich Brink* explained that the issue of recourse related to which party beared the risk of the debtor defaulting. In recourse factoring, the assignor would bear the risk whereas in non-recourse factoring the factor would bear the risk. He suggested that it was a matter to be determined by the parties to the factoring contract and should not be addressed in the MLF. *Mr Wilde* agreed with Mr Brink.

86. *Mr Enga Kameni (AFREXIMBANK)* suggested that the MLF should not address the minutia of recourse factoring as national laws dealt with these issues.

87. *Mr Peter Mulroy (FCI)* agreed that the minutia of recourse and non-recourse factoring touched upon a number of issues such as termination, dilution, fraud and illegitimate assignments.

However, he suggested that given the MLF would also be a vehicle to educate parties, it would be useful for the instrument's commentary to provide advice on the difference between recourse and non-recourse factoring.

88. *Mr Steven Geerlings (WOA)* suggested that there might be some benefit to the MLF itself trying to set a standard in relation to how recourse could affect the recharacterisation of an outright transfer as a security assignment or *vice versa*.

89. *Mr Richard Kohn (SFN)* suggested that the concept needed to be addressed in the MLF or the commentary, at least to clarify that the instrument applied to both recourse and non-recourse factoring. He agreed with Mr Geerlings that there would be benefit to the Working Group considering whether the instrument could address the recharacterisation issue and provide guidance as to when a contract could provide limited recourse without recharacterising an outright transfer as a security assignment.

90. *Ms Catherine Walsh* agreed that the issue of recharacterization should be addressed in either the MLF or the commentary. She noted that there might be benefit in clarifying in the black letter rules themselves that in the absence of a recourse provision in the contract, the assignee bears the risk of debtor default, which would be consistent with the Receivables Convention.

91. *Ms Louise Gullifer* agreed that the MLF should apply to both recourse and non-recourse factoring. She noted that there were two separate issues: first, whether the MLF should explicitly provide a rule clarifying that in the absence of a recourse provision the assignee beared the risk of debtor default, as consistent with the Receivables Convention and the AFREXIMBANK Model Law. She suggested that the Working Group needed to consider to what extent the MLF should include such default rules or leave it to the parties to the factoring contract to allocate risk and recourse. The second issue was whether the MLF should try to address how recourse would affect recharacterisation.

92. *The Chair* suggested that it might be preferable for the MLF to include default provisions which parties could contract out of.

93. *Mr Alejandro Garro* suggested that trying to define recourse and non-recourse factoring in the instrument itself might create additional challenges and it might be preferable to address it in the commentary.

94. *Mr Edward Wilde (FCI)* noted that defining recourse was not complicated, it was simply the obligation of the assignor to buy back the debt. He explained that the complicated part was the grounds on which recourse could be exercised, which often filled two pages of a contract and could include 25 different default events.

95. *Mr Jin Saibo* noted that the Chinese Civil Code made a distinction between recourse and non-recourse factoring. He explained that the Supreme People's Court had ruled that a factor that had recourse against a creditor could not seek money from the debtor, even if its obligation had not been fully satisfied by the creditor through the recourse arrangement. He noted that this decision had caused some issues for factors.

96. *The Chair summarised the discussion. The Working Group agreed that the MLF would apply to both recourse and non-recourse factoring but would leave the definition of these terms to the commentary. The Working Group had not yet reached a firm conclusion on the extent to which the instrument should assign the risk of debtor default or leave this to the parties. The Working Group had also not yet reached a conclusion on whether the instrument or its commentary should address how recourse affected the recharacterisation of outright transfers and security assignments.*

vii. Application to consumers – consumers as assignors and assignees

97. *The Chair* opened the floor for comments on whether the MLF should apply to assignments by consumers (where the consumer is the assignor of the receivable).

98. *Mr Neil Cohen* noted that this issue had become more complicated in recent times. He explained that for most consumers, the most common contractual right was the right to be paid wage, which was a right that States generally would not want to be governed by the MLF. He noted that in some instances consumers were the beneficiary of settlement agreements (for example, in relation to a personal injury) which would be a receivable. With the rise of ecommerce, the line between consumers and small businesses had become blurred, as amateurs selling goods on eBay were likely to be classified as consumers.

99. *Ms Louise Gullifer* agreed with Mr Cohen that it had become more challenging in identifying consumer receivables for exclusion when considering platforms like eBay. She suggested that the Working Group would not want to adopt a rule regarding consumers that would further complicate the situation.

100. *Mr Ulrich Brink* agreed that is was difficult to draw line between consumers and businesses. A sole trader could be considered a consumer in one jurisdiction and a business in another. He suggested that it might be unnecessary to limit the scope of the MLF in relation to consumer receivables, both because making the distinction between a consumer and a small business would be complicated and because there would be no harm caused by including receivables owed to consumers within the scope of the instrument. He explained that this position could be contrasted with the treatment of consumers as debtors where a State's consumer protection laws would apply.

101. *Mr Neil Cohen* suggested that should the MLF apply to assignments by consumers, it might be necessary for the instrument or commentary to suggest that States would need to clarify in their implementing legislation what types of receivables could not be assigned, for example contract dispute settlements or wage claims.

102. *Mr Marek Dubovec (NatLaw)* noted that if the MLF was to try to provide exclusions regarding receivables owed to consumers it would be for the State to decide which carve-outs to include in their legislation. He agreed that it was difficult to distinguish between consumers and businesses in the eBay context. He concluded that if the ultimate objective of the MLF was to make financing easier, then perhaps the best approach would be to include such receivables within the scope of the instrument and then provide options for States to put limitations on certain types of assignments by consumers.

103. *Ms Megumi Hara* explained that there had been an issue with the factoring of wages in Japan. Companies that were factoring wages had argued that they were not lenders under financial service regulations on the basis that they were merely the buyers of wage receivables and were not lending or providing a financial service. In response, the Government created three criteria to determine whether the purchase of wage receivables should be characterised as a loan: if (i) the power to collect was left to the assignor, (ii) there was a recourse agreement and (iii) there was no notification to or consent by the debtor/employer, then the company was considered to be lending rather than buying receivables.

104. *Ms Louise Gullifer* explained that in the United Kingdom crowdfunding platforms now existed that raised money for individuals, which in some cases were auctions for receivables under which consumers might buy receivables. She queried whether this would also need to be addressed in the MLF.

105. *Mr Saibo Jin (FCI)* noted that in China there were no limitations in the Civil Code in relation to consumer assignments. He explained that the receivables from consumer online transactions through platforms such as Ali Baba and jd.com were significant and should be included within the scope of the MLF.

106. *Mr Ulrich Brink* agreed with Ms Gullifer that the MLF should not exclude the transfer of receivables to consumers in order to allow them to take part in crowd funding measures. However, he suggested that the MLF might clarify that it did not override any applicable consumer protection legislation, otherwise it would face opposition from consumer protection groups.

107. *Mr Steven Geerlings (WOA)* noted that there had been recent developments in the field of consumer credit regulation and that further regulation was expected as a result of the global COVID19 pandemic. He suggested that the should Working Group consider such developments to ensure that the MLF remained attractive to implementing States.

108. *The Chair summarised the discussion. The Working Group decided that it did not yet want to exclude the assignment of receivables by consumers or to consumers (consumers as assignors and assignees). Further research on these matters was required.*

viii. Application to consumers – consumers as debtors

109. *Mr Ignacio Tirado (UNIDROIT)* explained that he was aware of several jurisdictions in which there were prohibitions on the assignment of consumer debts on the basis that collection companies were too aggressive in collecting such debts. He noted that States were unlikely to have the same concerns about factoring companies as collection by factors would be more supervised than the collection by debt collection companies. He concluded that it might make sense to include consumer debts within the scope of the MLF.

110. *Ms Catherine Walsh* suggested that the MLF should include some sort of consumer protection consistent with rules in the Receivables Convention and the Secured Transactions Model Law.[2]

111. *Mr Edward Wilde (FCI)* noted that there was a growing market for medical receivables and that in the United Kingdom there was a large market for the factoring of utility bills. He suggested that consumer receivables should be included within the scope of the MLF.

112. *Ms Louise Gullifer* noted that if the MLF was going to include a provision modelled on Article 4(4) of the Receivables Convention, additional language should be added to include consumers as assignees to reflect the issues related to crowdfunding platforms discussed earlier.

113. *Mr Neil Cohen* agreed with Ms Gullifer that the rule should be based on Article 1(5) of the Secured Transactions Model Law, as adapted to include consumers as assignees. He noted that if there was an unusual or unique protection for consumers in an enacting State then that State could adapt the rule as necessary.

114. *Mr Alejandro Garro* agreed that the MLF should refer to domestic law protections of consumers as debtors, assignors and assignees. He noted that Article 4(4) of the Receivables Convention created a definition of consumer transactions *("laws governing the protection of parties to transactions made for personal, family or household purposes")* that might not be consistent with

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[2] Article 4(4) of the Receivables Convention provides "Nothing in this Convention affects the rights and obligations of the assignor and the debtor under special laws governing the protection of parties to transactions made for personal, family or household purposes." Article 1(5) of the Secured Transactions Model Law provides that "Nothing in this Law affects the rights and obligations of the grantor and the debtor of the receivable under other laws governing the protection of parties to transactions made for personal, family or household purposes."

the definition of consumer transactions in many States. He queried whether it would be preferable to simply state that the MLF does not override consumer protections. *The Chair* agreed that it might be preferable for the instrument to defer to the applicable law and not define consumer transactions.

115. *Mr Marek Dubovec (Natlaw)* agreed with Mr Garro, and noted that the proposed approach to consumer protections had also been discussed in relation to negotiable instruments, under which the scope of the instrument would be broad but it would defer to the applicable law of the implementing State to determine the exact nature of the deferral. He suggested that even if the MLF provided a definition of a consumer transaction, it would be unlikely that implementing States would amend their existing definition to accommodate the MLF definition.

116. *Mr Neil Cohen* suggested one approach could be to insert an improved definition of consumer protection transaction in brackets and explain to implementing States that they could insert their own definition. He explained that it might be beneficial to provide some form of definition or exemplary language, which might in some cases provide better guidance than existing unclear consumer protection laws.

117. *Ms Anna Veneziano (UNIDROIT)* noted that this topic might benefit from additional commentary to provide clarity on the issue, instead of trying to craft a black letter rule.

118. *Mr John Wilson (IFC)* noted that a growing number of States were implementing laws regulating fintech platforms that carved out protections for the platforms or individual investors. He noted that such consumer financial protection laws might affect consumers as assignees under the MLF and that the MLF should also defer to such laws. He suggested that the Working Group consider these laws in deciding their approach to consumer protection in the MLF.

119. *Mr Peter Mulroy (FCI)* noted that one of the challenges that the industry faced was usury laws in consumer finance. He noted that some FCI members were factoring consumer receivables such as from cable television services and issues had arose where the cable television services had been immediately ceased due to collection issues. He welcomed any comments the Working Group might have on usury.

120. *The Chair summarised that the Working Group favoured the application of the MLF to consumer transactions where the consumer was the assignor, assignee or debtor, although with a deferment to any existing applicable consumer protection laws in the implementing State. There was no consensus on whether the MLF should provide a definition of consumer transactions as based on Article 4(4) of the Receivables Convention as an exemplary provision, or whether it should just defer to the domestic consumer protection laws. He suggested that the MLF might also need to defer to fintech regulation and financial consumer protection laws that protected consumers as assignees, although further research was required on this matter.*

ix. Additional functions performed by the factor

121. *The Chair* introduced the topic with reference to paragraph 64 of Doc. 2. He posed two questions. First, he asked whether the MLF should require the factor to provide additional functions, as consistent with Article 1(2) of the Factoring Convention. Second, he asked whether the MLF or its commentary should provide additional guidance on these possible additional functions that could be provided by the factor.

122. *Mr Murat Sultanov (IFC)* explained that the United Arab Emirates (UAE) had been in the process of launching a payables finance (reverse factoring) platform but had experienced some challenges in encouraging anchor buyers to join the platform. He noted that factors had been trying to provide additional incentives to encourage anchor buyers to join the platform. The platform

allowed for confirmation of the goods/services to be provided, confirm delivery of the goods/services and that the goods/services were of the right quality, then upload the invoice and confirm that the anchor buyer was willing to pay within 30-90 days. The platform would then allow the supplier to select some invoices for early repayment, trigger the purchase agreement and allow the supplier to receive payment on the first day that the invoice was issued. He emphasised that the functions provided through the platform were much broader than simply transfer of the receivable and concluded that the MLF or the commentary should clarify that the services provided by the factor could be much broader than just the transfer of receivables.

123. *Mr Ulrich Brink (FCI)* noted that when the Factoring Convention was created in the 1980s factoring businesses operated very differently. He explained that the functions listed in the Factoring Convention of collection, sales and accounting were the typical business of a factor at the time. In the digital era, sales ledgering was generally undertaken by the assignor rather than the factor. Factors now had a variety of different business models, which included traditional factoring contemplated in the Factoring Convention, maturity factoring, recourse and non-recourse factoring and payables finance. He concluded that it was no longer necessary for an instrument to provide restrictions in terms of the obligations or functions imposed on factors.

124. *Mr Edward Wilde (FCI)* noted that the European Union were considering classifying factoring as an insurance product. He cautioned that where factors did not provide additional functions they risked being classified as insurance companies and would thus be subject to insurance regulatory frameworks. He suggested that the MLF should require factors to provide additional functions, as consistent with the Factoring Convention.

125. *Mr Neil Cohen* agreed with Mr Brink that trying to describe all possible functions provided by factors in 2020 would risk the instrument becoming anachronistic. He emphasised that the purpose of the MLF was to provide States not yet ready for a full secured transactions law reform with a first step to facilitate factoring. In this context, he queried whether providing more guidance on the functions undertaken by factors would be likely to incentivise States to adopt the MLF.

126. *Mr Marek Dubovec (NatLaw)* agreed with Mr Cohen. He identified a second category of States such as the UAE that had recently enacted a secured transactions law but required additional rules to facilitate certain types of financing that had not flourished under the secured transaction reform, such as factoring. In relation to the risk of factoring companies being subjected to insurance industry regulations, he suggested that it was unlikely that the regulator would consider the wording of the factoring law in determining whether a factoring company was providing an insurance service, but would instead look at the services being provided. He suggested that there would be no benefit of the MLF requiring factors to perform additional functions.

127. *Mr Bruce Whittaker* agreed with Mr Dubovec. He noted that the objective of the law was for businesses to use receivables to gain access to credit and that the law should be engaged if there was an assignment of receivables, regardless of whether the factor provides additional services.

128. *Mr Michel Deschamps* agreed that there was no need for the MLF to require factors to provide additional functions. He noted that the distinction between credit insurance and factoring was that when receivables were the subject of credit insurance, they would not be transferred at the time the insurance coverage begins but instead be transferred after a payment was made by the insurance company, at which point the insured creditor would transfer the receivable to the insurance company. He further noted that the MLF might need to define “factoring” but should not attempt to define “factor”.

129. *Mr Jin Saibo* noted that under the Chinese Civil Code regulators required factors to have a licence whereas other types of supply chain finance did not require a licence, so companies

undertaking both factoring and supply chain finance needed to comply with two different sets of regulations.

130. *Mr Richard Kohn (SFN)* agreed that the MLF should not require factors to provide additional functions as such a requirement would place a severe limitation on the utility of the instrument and potentially exclude future types of receivables finance products that had not yet emerged.

131. *Ms Louise Gullifer* also agreed that the MLF should not require factors to provide additional functions. However, she cautioned that not requiring additional functions might inadvertently include other types of financing within the scope of the instrument, such as a bank lending against a company's assets. She suggested that the Working Group would need to give the issue further consideration.

132. *Mr Erik Timmermans (WOA)* suggested that the Working Group developing a clear definition of factoring would address some of the issue being raised. He agreed that the MLF should not require factors to provide additional functions.

133. *Mr Alejandro Garro* noted that Article 2 of the Factoring Convention provided a definition of a factoring contract: "*a contract concluded between one party (the supplier) and another party (the factor) pursuant to which the supplier may or will assign to the factor receivables arising from contracts of sale of goods made between the supplier and its customers (debtors).*"

134. *The Chair* asked the Working Group how the definition of factoring should be constructed without reference to the functions performed by the factor.

135. *Mr Giuliano Castellano* noted that the regulatory aspects needed to be kept in mind, referring to the Chinese situation where companies would make decisions about the services they offered based on the regulatory framework. He suggested that many States would require some form of licencing for factoring companies and that in Hong Kong a number of receivables finance companies had been told they required a securities licence. He suggested that some other banking and finance regulations such as prudential regulation did not need to be considered by the Working Group.

136. *Mr Michel Deschamps* suggested that the definition of "factoring contract" in the Factoring Convention was too restrictive as it would not include credit card receivables or loans. He suggested that it was important for the MLF to apply to receivables that were secured, protected by a guarantee and insured.

137. *Mr Bruce Whittaker* suggested that the definition of factoring should take into account the primary objective of the instrument as a tool to make it easier for companies to use receivables to raise credit, rather than to facilitate factoring as it currently existed.

138. *Mr Murat Sultanov (IFC)* explained that there had been similar discussions during the development of the Model Law on Leasing, in relation to whether the instrument should provide guidance to State on the supervision of leasing, licencing requirements and other regulatory matters. It was ultimately decided not to address such matters in the Model Law on Leasing or its commentary, however this decision had caused problems for States implementing the Model Law who requested guidance on these regulatory matters. He concluded that it would have been better if the Model Law on Leasing had provided guidance on these matters.

139. *The Chair summarised the discussion. The Working Group decided that the MLF should not require factors to perform additional functions, although further work was required to ensure that the scope of the instrument was not unduly broad.*

x. Future receivables

140. *The Chair* introduced the topic with reference to paragraphs 65 - 66 of Doc. 2. He asked the Working Group whether the MLF should impose requirements on the transfer of future receivables.

141. *Mr Orkun Akseli (observer)* noted that the Receivables Convention and the Secured Transactions Model Law did not impose additional requirements for the transfer of future receivables. He recommended that the MLF did not impose additional requirements on the transfer of future receivables as doing so could risk increasing the cost of credit. *Ulrich Brink (FCI)* and *John Wilson (IFC)* agreed with Mr Akseli.

142. *Ms Louise Gullifer* agreed that the MLF should apply to future receivables. She noted that an issue had arisen under United Kingdom law in relation to when and how the debtor should be notified of an assignment of future receivables. She explained that two possible approaches could be to (i) not require notification to the debtor until the receivable has arisen, or alternatively (ii) in circumstances where the identity of the debtor was known, allow notification at the time the agreement is concluded. She concluded that the rule was not clear in the United Kingdom and that the Working Group might wish to give the issue further consideration.

143. *Ms Megumi Hara* noted that a similar issue had arisen in Japan and that the identification criteria for the registration and notification of receivables were different. She suggested that in any notification to the debtor it would need to be clear what receivable was being assigned.

144. *Mr Marek Dubovec (NatLaw)* also agreed that the MLF should enable the creation and transfer of future receivables. He noted that in relation to future receivables under the Secured Transactions Model Law, the transfer occurred when the assignor acquired the rights in the receivable or the power to encumber it. He explained that there had been discussions during the negotiation of the Secured Transactions Model Law regarding the power to encumber, specifically in relation to where the assignor sold the receivable outright and then created a security right in the same receivable. The question that arose was which rights the assignor retained so as to transfer the same receivable again. He suggested that the Working Group could provide guidance on this issue.

145. *Ms Megumi Hara* queried how future receivables should be treated in the insolvency context. She explained that the uncertainty arose in Japan in this context, which was partially due to a lack of clarity as to what exactly was being assigned in relation to a future receivable. She noted that it would be difficult for the MLF to include only a partial insolvency rule in relation to future receivables, although there would still be benefit in the Working Group considering this issue.

146. *The Chair summarised the discussion. The Working Group agreed that the MLF should apply to the creation and transfer of future receivables and that the instrument should not impose additional requirements on such transfers. Several issues arose in relation to future receivables that required further consideration: (i) debtor notification issues, (ii) the power to encumber and (iii) the treatment of future receivables in an insolvency context.*

xi. Anti-assignment clauses

147. *The Chair* introduced the topic with reference to paragraphs 67 - 68 of Doc. 2. He explained that the main issue for the Working Group to consider was whether the MLF should include a provision overriding the effect of anti-assignment clauses.

148. *Mr Ulrich Brink (FCI)* noted that Article 6 of the Factoring Convention[3] and Article 9(1) of the Receivables Convention[4] provided rules overriding the effect of anti-assignment clauses. He stated that it was important for the factoring industry that debtors could not prevent the financing of the assignor by a factor. He explained that the Receivables Convention essentially limited the overriding of anti-assignment clauses to certain types of receivables.[5] He concluded that while anti-assignment clauses should generally be overridden, there were some exceptions in relation to certain transactions such as for military procurement.

149. *Mr Chris Wolhert (APEC IFDN)* supported the MLF overriding anti-assignment clauses. He explained that the MLF would play an important role in developing economies in improving access to credit for micro, small and medium enterprises (MSMEs) by allowing them to assign future receivables. In this context, he noted that anti-assignment clauses placed a large burden on MSMEs in terms of transactional and due diligence costs and it was important for the MLF to override them.

150. *Mr Orkun Akseli (observer)* agreed that anti-assignment clauses should be overridden in the MLF. He suggested that the provision should be broadly construed and apply beyond just trade receivables.

151. *Ms Louise Gullifer* noted that the United Kingdom had recently passed reforms in relation to anti-assignment clauses. She agreed that enabling access to credit for MSMEs should be the primary focus of the rule. She cautioned that the financing industry was likely to protest against expanding the overriding of anti-assignment clauses beyond trade receivables on the basis that it would cause problems for a range of financial transactions, such as netting. She noted that in the United Kingdom, exceptions in relation to national security and confidentiality also existed and that States implementing the MLF would have to grapple with these issues.

152. *Mr Marek Dubovec (NatLaw)* noted that while there appeared to be support for the MLF overriding anti-assignment clauses, it was difficult to decide exactly how it should be achieved. He suggested that the MLF would have to balance the role of anti-assignment clauses in protecting certain parties with the importance of the instrument facilitating credit for MSMEs. He noted that the treatment of anti-assignment clauses differed in relation to negotiable instruments.

153. *Mr Orkun Akseli (observer)* noted that many States would have statutory restrictions on the assignment of certain receivables such as wages and social security payments. He suggested the MLF should distinguish between restrictions on anti-assignment clauses and the treatment of statutory restrictions of certain types of assignments. *Ulrich Brink (FCI)* agreed that legal limitations on the transfer of certain receivables such as wages or medical receivables was a distinct issue that should be discussed separately.

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[3] Article 6 of the Factoring Convention provides:
1. The assignment of a receivable by the supplier to the factor shall be effective notwithstanding any agreement between the supplier and the debtor prohibiting such assignment.
2. However, such assignment shall not be effective against the debtor when, at the time of conclusion of the contract of sale of goods, it has its place of business in a Contracting State which has made a declaration under Article 18 of this Convention.
3. Nothing in paragraph 1 shall affect any obligation of good faith owed by the supplier to the debtor or any liability of the supplier to the debtor in respect of an assignment made in breach of the terms of the contract of sale of goods.

[4] Article 9(1) of the Receivables Convention provides: *An assignment of a receivable is effective notwithstanding any agreement between the initial or any subsequent assignor and the debtor or any subsequent assignee limiting in any way the assignor's right to assign its receivables.*

[5] Article 9(3) of the Receivables Convention provides *This article applies only to assignments of receivables:*
(a) Arising from an original contract that is a contract for the supply or lease of goods or services other than financial services, a construction contract or a contract for the sale or lease of real property;
(b) Arising from an original contract for the sale, lease or licence of industrial or other intellectual property or of proprietary information;
(c) Representing the payment obligation for a credit card transaction; or (d) Owed to the assignor upon net settlement of payments due pursuant to a netting agreement involving more than two parties.

154. *Mr Richard Kohn (SFN)* explained that while the Factoring Convention and Receivables Convention invalidated anti-assignment clauses, they preserved the right of the debtor to sue for breach of contract.[6] He explained that these articles had a chilling effect on assignors who often decided not to factor their receivables to avoid any potential liability for breach of contract. He suggested that the MLF should completely override anti-assignment clauses without preserving a debtor's right to sue for breach of contract.

155. *Mr Ulrich Brink (FCI)* agreed that the MLF should not preserve the debtor's right to sue for breach of contract in relation to an anti-assignment clause. He noted that this approach would not disadvantage the debtor, as all it required of the debtor was to pay a different creditor. He further noted that the debtor's other defences and set-offs should be preserved. He concluded by urging the Working Group to follow the model of the AFREXIMBANK Model Law in not preserving the debtor's right to sue for breach of contract in relation to anti-assignment clauses.

156. *Ms Louise Gullifer* noted that while the Secured Transactions Model Law and Canadian Personal Property Securities Act (PPSA) did allow a debtor to sue an assignor for breach of an anti-assignment clause, these laws only allowed the debtor to recover damages rather than terminate the agreement. She further noted that it was difficult to determine what the damages for breach of an anti-assignment clause would be. She suggested that even where a breach of an anti-assignment clause did cause damages by negatively affecting the debtor's rights to confidentiality, the assignor's action would also breach the confidentiality clause in the agreement. Accordingly, she concluded that there did not appear to be a strong rationale for the MLF to preserve the debtor's right to sue for breach.

157. *Mr Neil Cohen* agreed with Mr Kohn and Ms Gullifer. He noted that retaining the debtor's right to sue for breach of contract in relation to an anti-assignment clause would disincentivise MSMEs from seeking to factor their receivables as they would have to take into account litigation risks. He explained that United States law provided a strong override of anti-assignment clauses for most types of receivables except for loan receivables. He explained that there was no conceptual or policy justification underpinning the rule, it merely reflected the preferences of certain domestic special interest groups. He suggested that the Working Group might need to consider effectively limiting the MLF overriding anti-assignment clauses to trade receivables to ensure it was politically acceptable.

158. *Mr Orkun Akseli (observer)* agreed that as long as the MLF preserved the debtor's defences and set-offs, the instrument should provide for a complete override of anti-assignment clauses. He mentioned that in some jurisdictions there was tortious liability of assignees who incentivised assignors to breach their underlying contract with the debtor. He queried whether the MLF would include such a concept. *The Chair* noted that it was unclear at this point.

159. *Mr Ulrich Brink (FCI)* noted that the Working Group would have to consider the applicability of anti-assignment clauses in relation to each receivable included within the scope of the MLF. He noted that anti-assignment clauses applied for different reasons in different contexts, such as anti-money laundering provisions or the transfer of bank accounts. He suggested that if the MLF included bank account as receivables within its scope, the instrument would have to include an exception for bank accounts in relation to the overriding of anti-assignment clauses.

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[6] Article 6(3) of the Factoring Convention provides:
Nothing in paragraph 1 shall affect any obligation of good faith owed by the supplier to the debtor or any liability of the supplier to the debtor in respect of an assignment made in breach of the terms of the contract of sale of goods.
Article 9(2) of the Receivables Convention provides:
Nothing in this article affects any obligation or liability of the assignor for breach of such an agreement, but the other party to such agreement may not avoid the original contract or the assignment contract on the sole ground of that breach. A person who is not party to such an agreement is not liable on the sole ground that it had knowledge of the agreement.

160. *Ms Catherine Walsh* noted that the approach of the Canadian PPSA in allowing the debtor to sue for the breach of an anti-assignment clauses was also reflected in the *UNIDROIT Principles of International Commercial Contracts*. She explained that there could be damages from an assignor's breach of an anti-assignment clause if it resulted in the loss of the business relationship between the debtor and the assignor. She concluded that there might be some resistance to the MLF completely overriding anti-assignment clauses.

161. *Ms Megumi Hara* noted that in Japan the same issue of what constitutes as the damage for breaching an anti-assignment clause arose during the recent Japanese law reform process. One possibility may be that a debtor could sue for mental damage resulting from an assignor's breach of an anti-assignment clause. She further queried that the bigger issue may be whether the MLF would override a clause in the underlying contract that fined the assignor for breach of contract including fine for violating anti-assignment clause. She noted that this issue also arose during the recent Japanese law reform process.

162. *The Chair summarised the discussion. The Working Group agreed that the MLF should completely override anti-assignment clauses without preserving the debtor's right to sue for breach of contract. The Chair noted that the Working Group needed to give further consideration to (i) statutory bars on the types of receivables that could be assigned and (ii) whether the instrument should limit the types of receivables for which anti-assignment clauses would be overridden.*

xii. Application to different categories of receivable finance

163. *The Chair* introduced the topic with reference to paragraphs 69 – 73 of Doc. 2.

164. *Mr Ulrich Brink (FCI)* suggested that the Working Group should adopt a functional approach in considering the different types of receivables financing to be included within the scope of the MLF. He explained that receivables financing practices had evolved considerably since the Factoring Convention was adopted in 1989 and that the MLF should adopt a flexible approach that would allow new receivables financing products to be included within the scope.

165. *Mr Richard Kohn (SFN)* agreed with Mr Brink. He noted that when assessing different receivables financing platforms or categories, the basic consideration should be whether value was being given. He recommended that the instrument should be expansive in the types of transactions it covered to allow it to accommodate technological innovation.

166. *Mr Bruce Whittaker* agreed that the MLF should accommodate receivables financing products that would achieve its aim of allowing businesses to use their receivables to raise credit.

167. *Mr Peter Mulroy (FCI)* noted that one of the benefits of the MLF would be to create greater clarity in relation to the legal regime regulating different receivables financing products. In providing established legal principles, the instrument would assist in achieving clarity, conformity and standardisation in receivables financing allowing receivables to be treated as investable asset class.

<u>Discounting</u>

168. *The Working Group agreed that the practice of discounting should be included within the scope of the MLF.*

Forfaiting

169. *Mr Bruce Whittaker* noted that forfaiting involved the purchase of future payment obligations represented by negotiable instruments. He suggested that whether forfaiting would be within scope of the MLF would depend on the Model Law's broader treatment of negotiable instruments.

170. *Mr Eric Timmermans (WOA)* suggested that forfaiting was a separate practice relying on the use of negotiable instruments and should be excluded from the MLF.

171. *Mr Ulrich Brink (FCI)* urged caution in relation to the use of the term "forfaiting". He explained that the term forfaiting was not uniformly used to describe transactions involving negotiable instruments. He noted that a bulk assignment of receivables in a single transaction, such as thousands of credit card payments would in some circumstances be called "forfaiting". *Mr Michel Deschamps* agreed, noting that some banks in Canada and the United States used the term "forfaiting" to describe the purchase of receivables that were not necessarily represented in a negotiable instrument. *Steven Geerlings (WOA)* noted that in the Netherlands the term was used to describe receivables finance in a trade context.

172. *The Working Group did not reach consensus on whether forfaiting should be included within the scope of the MLF. It was agreed that the treatment of forfaiting would depend on the MLF's broader treatment of negotiable instruments. The Working Group noted that the term "forfaiting" was used to refer to different financing practices and that it should not be used in the instrument itself.*

Payables finance (reverse factoring)

173. *The Chair* noted that it was clear that payables finance was an important aspect of the factoring industry and needed to be included within the scope of the MLF. He asked the Working Group whether specific rules or commentary would be required in relation to payables finance.

174. *Mr Ulrich Brink (FCI)* noted that in a payables finance transaction, the debtor would often confirm that it is willing and able to make payment. In such circumstances, where the debtor has promised to pay the debt, such a promise should constitute a waiver of the debtor's defences. He suggested that the Working Group should consider how such waivers would be dealt with in the MLF.

175. *Mr Michel Deschamps* agreed with Mr Brink. He explained that in some payables finance transactions, the debtor agreed to include a waiver that amounted to giving the assignee the equivalent rights of a holder in due course. He further explained that this arrangement was not reflected in the underlying contract between the debtor and the assignor. Instead, the debtor would accept the assignment on notification and confirm that it would pay the assignee, which put the assignee in the position roughly equivalent to a holder in due course. He concluded that the provisions in the MLF governing waivers should ensure that the arrangement he had just described would not be impaired.

176. *Mr Peter Mulroy (FCI)* agreed that it was essential for the MLF to apply to payables finance. He noted that the industry had experienced the largest growth in payables finance in emerging markets.

177. *Mr Richard Kohn (SFN)* highlighted the importance of payables finance for MSMEs and suggested that they be addressed in some detail in the MLF commentary.

178. *Mr Marek Dubovec (NatLaw)* agreed that payables finance was particularly important in emerging markets. He suggested that there was no need to signal that payables finance was within the scope of the instrument in the black letter rules themselves, although it would be useful for the commentary to include an explanation of the practice.

179. *Ms Louise Gullifer* noted that in payables finance relationships, there was often an anti-assignment clause in the underlying contract to ensure that the assignor would not assign the receivables to any party except the debtor's bank. She queried whether the Working Group's decision to provide a complete override of anti-assignment clauses in the MLF would cause problems in payables finance arrangements where the debtor wanted to ensure that the receivables would only be assigned to the debtor's preferred bank. As a separate matter, Ms Gullifer recalled discussions during the negotiation of the Secured Transactions Model Law Practice Guide regarding financing arrangements where receivables were assigned to a assignee and then reassigned to another party, in a A-B-C-D arrangement. She queried whether this sort of arrangement would be within the scope of the MLF.

180. *Mr Richard Kohn (SFN)* noted that he was familiar with successive assignment arrangements which involved a receivable being first assigned to one entity which provided certain services and was then subsequently reassigned to investors. He suggested that there would be no issue with the MLF applying to such an arrangement.

181. *Mr Ulrich Brink (FCI)* suggested that the MLF completely overriding anti-assignment clauses would not cause any problems with respect to payables finance. He also explained that factors often had refinancing arrangements with banks, under which the factor would offer the receivable as collateral to a bank refinancing the factor and would therefore become an assignor of the receivable. He suggested that this matter should be reconsidered in greater detail at a later point.

182. *Mr Steven Geerlings (WOA)* suggested that the MLF should act as a tool to avoid the characterization of a reverse factoring arrangement as a loan.

183. *Mr Giuliano Castellano* noted that it is important for the MLF or the commentary to provide for a clear definition of payables finance both to avoid characterisation issues but also to clarify the nature of the transaction for regulatory purposes. He queried whether the MLF could be accompanied by a definitions document, or whether these matters would be addressed in the commentary. *The Chair* noted that either a definitions document or an expanded commentary addressing these matters could be included as part of the broader project.

184. *Mr Marek Dubovec (NatLaw)* noted that the term "recharacterization" was used in two different contexts. The first was the legal context which related to whether the assignee's recourse meant that a transfer was considered to be a sale or a security interest. The second meaning related to the accounting context and whether an obligation of an account debtor would be considered as a payable or a loan. He noted that the accounting context was economically important but not something that a commercial law instrument should deal with, although it could be addressed in the commentary.

185. *The Working Group agreed that payables finance would fall within the scope of the MLF. The Working Group noted that certain issues arose in relation to waivers and defences in the context of payables finance that might require further consideration. The Working Group noted that the commentary to the MLF should provide further guidance to States describing the operation of payables finance and address recharacterization issues.*

(c) Content and structure of the Model Law

i. Formalities

186. *The Chair* introduced the topic with reference to paragraph 74 of Doc. 2. He noted that the Working Group might wish to consider whether the MLF should expressly provide whether formalities were required.

187. *Mr Orkun Akseli (observer)* suggested that the MLF should not require formalities as a condition for the creation of a security right or transfer of receivables. He explained that formalities had become even more unnecessary in the digital age and suggested that the text should explicitly provide that formalities were not required.

188. *Mr Ulrich Brink (FCI)* agreed with Mr Akseli and suggested that minimising the role of notaries in factoring arrangements lowered transactional costs.

189. *Mr Marek Dubovec (NatLaw)* agreed that formalities should not be required. He noted that there were different approaches to achieving this policy. He explained that some States explicitly stated what formalities were not required (for example, domestic legislation could provide that certain transactions "were exempted from Stamp Duties").

190. Mr *Bruce Whitaker* agreed with the policy that no particular formalities should be required. In relation to drafting, he suggested that it would be difficult to describe what was meant by "formalities" as a definition in the instrument itself.

191. *Mr Steven Geerlings (WOA)* suggested that while it might not be necessary for the MLF itself to explain formalities, it would be useful for the commentary to provide further guidance to implementing States.

192. *Mr Neil Cohen* noted that the MLF could explicitly provide that formalities were not required by stating that "the only formal requirements are…". He agreed that guidance needed to be given to enacting States to explain that if they had specific formal requirements, they might wish to explicitly carve them out in the domestic implementing legislation.

193. *Mr Alejandro Garro* noted that in many States there would be formal requirements. He suggested that the MLF could include some text which provided that formal requirements relating to both validity and evidence could be satisfied by witnesses and that no specific form was required. He noted that this would still be a radical change in some States.

194. *The Working Group agreed that the MLF should not require formalities as a condition for the creation of a security right or transfer of receivables. The Working Group left open how this policy should be achieved in the text of the instrument. The Working Group agreed that the commentary to the MLF should provide further guidance to enacting States on the treatment of formalities.*

ii. Priority

195. *The Chair* introduced the topic, with reference to paragraphs 75 – 81 of Doc. 2. He noted that the annexes to the Receivables Convention provided three different approaches to priority and perfection.

196. *Mr Marek Dubovec (NatLaw)* emphasised the importance of the MLF having a comprehensive framework for resolving priority conflicts. He noted that priority conflicts arose not only between two assignees but that the industry was facing priority issues associated with preferential claims, priority on insolvency and conflicts between consensual and non-consensual creditors.

197. *Mr Ulrich Brink (FCI)* noted that the Factoring Convention had only been ratified by 9 States, which was in part due to its failure to provide a clear priority regime. He explained that during the negotiation of the treaty in the 1980s, States could not agree upon a special priority regime, which meant it was not addressed in the treaty. He suggested that it would be difficult for a model law to provide only one regime for priority and that a range of options should be provided to increase the attractiveness of the instrument to different States. He noted that the UNCITRAL Secured

Transactions Model Law used a registration system to resolve priority conflicts, which was favourable for factors but would not be acceptable in some States. He urged the Working Group to balance establishing best practice in the instrument with considerations of political viability.

198. *Mr Neil Cohen* noted that in the negotiation of the Receivables Convention, States initially tried to negotiate a uniform priority and perfection system. This had not been successful, so the compromise solution had been for the treaty to provide that applicable priority rules would be those of the implementing State and then provide conflict of laws rules in the instrument in order to determine which State's laws applied. He explained that in the negotiation of the Secured Transactions Model Law, consensus had been achieved in agreeing to a registration-based priority system. This was in part due to the flexible nature of the Secured Transactions Model Law. He cautioned the Working Group that if the MLF did not provide a uniform approach to priority then it might be considered to be a step in the wrong direction. He suggested that it would be preferable to have a clear priority system in the MLF in order to minimise frictions in cross-border transactions.

199. *The Chair* noted that the negotiation of a model law was different to the negotiation of a treaty and that the Working Group had more flexibility in trying to find uniform positions.

200. *Ms Megumi Hara* agreed with Mr Cohen that the Working Group should try to achieve the best possible model for States to follow, which would be a registration-based priority system. She noted that some legal systems allowed for priority and third-party effectiveness to be established by either notification to the debtor or registration, whichever was first in time. She suggested that this dual system did not work well. She noted that in the recent reform of the Japanese Civil Code there had been proposals that it should be a registration-only priority system, although this had been unsuccessful. She further explained that there are countries including Japan, that also allow consent of the debtor as method of third-party effectiveness. Although MLF should achieve registration-based system, she pointed out that there are instances in Japan where in practice, the assignee prefers to have consent of the debtor rather than notification or registration. She explained that consent of the debtor should be considered in broader aspect as well, as there could be mainly three other functions of the consent of the debtor aside from third party effectiveness. One function is consent of the debtor giving effect to enforcement against account debtor. Second function is eliminating the existence or effect of anti-assignment clause. In states that give proprietary effect to anti-assignment clause, consent of the debtor could give retroactive effect to assignments that are made in violation of anti- assignment clause. Third function is waiving the defence of the debtor. She concluded that while the MLF should have a registration-based priority system, the instrument should also deal with the different role the debtor consent may play.

201. *Ms Louise Gullifer* agreed that a registration-based priority system was the best approach for the MLF. However, she suggested that the Working Group needed to carefully consider Mr Brink's concern that a registration-based priority system was not globally popular. She explained that in the United Kingdom, she had been surprised that the factoring industry had argued against the registerability of outright assignments, on the basis that it was an unnecessary fraud-prevention measure. There had been stronger opposition from other parties undertaking financing against receivables, securitizations, loan receivables and financial assets. She noted that if the scope of the MLF was broader than just trade receivables, then there might be additional opposition to a registration-based priority system. Additionally, she suggested that it was important that a registry for factoring was a step towards a comprehensive security interests registry and did not instead lead to fragmentation.

202. *Mr Chris Wolhert (APEC IFDN)* noted that APEC had been encouraging States to implement a registration-based secured transactions reform. He explained that registration-based systems facilitated international trade, cross-border financial transactions, simplicity and transparency. He noted that for developing economies, a factoring registry could later be leveraged into a registry for

inventory and other moveables. He further noted that China had established two registries, one accounts receivable registry managed by the People's Bank of China, and a second separate registry for other movable collateral managed by a different bureaucracy. He explained that while the receivables registry had been very successful, the inventory registry had become problematic and obsolete, requiring in-person visits. China was now moving towards a centralised registry based on the receivables registry. He emphasised that an additional benefit of registration-based systems was that in emerging markets with less developed legal and judicial infrastructure and less sophisticated parties, registries increased transparency and decreased the risk of seller-debtor collusion and fraud.

203. *Mr Alejandro Garro* suggested that in Colombia and other jurisdictions in which he had worked, there might not be significant difficulty in shifting from a priority system based on the debtor's consent to a registration-based priority system. He suggested that protections for the debtor could be provided using means other than requiring the debtor's consent to establish third party effectiveness.

204. *Mr John Wilson (IFC)* suggested that the Working Group should have a broader discussion about the issue of debtor consent at a future meeting. He explained that the debtor's consent was important for other reasons aside from perfection. In many Latin American and civil law jurisdictions, the debtor's consent assured that notice had been provided and verification that the debtor was going to make payment at maturity, as well as reinforced enforceability. He suggested that these issues could be differentiated from the issue of third party effectiveness. He explained that when undertaking a secured transactions reform, the IFC considered a registry as a compulsory element, whereas when developing a reverse factoring system such as a fintech platform, the IFC considered a registry as desirable but not essential. This distinction was based on the fact that in traditional factoring, a seller uploaded its receivable onto the fintech platform and might have an incentive to make a fraudulent double assignment. In this context, the existence of a registry was essential to protect third parties. However, in the reverse factoring context, the debtor uploaded the receivables onto the fintech platform and there was no incentive to make a double assignment. He explained that as the MLF was addressing both traditional factoring and payables finance, it was essential that it was a registration-based system. He agreed that the instrument should not take a step backwards from the consensus that had been achieved at UNCITRAL in drafting the Secured Transactions Model Law. He concluded by explaining that many jurisdictions using e-invoicing used xml files which allowed parties to receive notice without checking the registry. This had resulted in some fintech models moving away from registration, although it was unclear whether such practices should be reflected in the MLF.

205. *Mr Steven Geerlings (WOA)* agreed that the MLF should not have a priority system based on the consent of the debtor. He explained that undisclosed factoring had become increasingly popular which had led to civil law States in Europe gradually eliminating debtor consent as a requirement for perfecting assignments and pledges. The notification of the debtor was not required for perfection from a property law perspective, although if the debtor was not notified it would pay the original creditor. In relation to registries, he noted that the registry environment was very diverse and that it would be almost impossible to harmonise all existing registry practices. He noted that the European Union was still working on the concept of a central registration system, although such a concept should not be reflected in the MLF as a central registration system for multiple States would be too complex and take too long to implement.

206. *Ms Catherine Walsh* suggested that the Working Group needed to carefully distinguish between notification and consent in relation to the effectiveness of an assignment against the debtor, as compared to notification and consent in relation to third party effectiveness and priority. In relation to effectiveness of an assignment against the debtor, she suggested that it might be preferable for the MLF to require simple notification rather than positive consent, as consistent with the Receivables Convention. In relation to the use of registries, she emphasised the importance of designing the MLF

to ensure that the receivables registry would develop into a full collateral registry, rather than resulting in a fractured system with multiple registries. However, she also cautioned that even where a dedicated asset registry existed, determining priority for the assignment of receivables and proceeds was challenging. Thus, she concluded that even if the MLF adopted a registration-based priority system, there would be further priority issues that the Working Group would have to address.

207. *Mr Michel Deschamps* noted that in legal regimes based on French civil law, debtor consent was required for effectiveness against the debtor, whereas notification was required for third party effectiveness. He explained that the notification of the debtor for third party effectiveness was almost a null issue, because if the debtor had consented to the assignment then it must also have been notified. He noted that debtor consent performed a different function in removing debtor defences.

208. *Mr Ignacio Tirado (UNIDROIT)* emphasised the importance of the MLF avoiding any possibility of fragmentation. In this regard, he noted the importance of the instrument being based on a registration system, in order for it to fulfill its purpose as a transitional step towards a comprehensive secured transactions registry based on the Secured Transactions Model Law.

209. *Mr Marek Dubovec (NatLaw)* agreed with Mr Tirado. He added that including a registration-based priority system in the MLF would also assist in its secondary purpose of supplementing newly adopted secured transactions laws in States that needed a model to develop domestic factoring practices. He noted that in many States, central banks were interested in operating collateral registries. As central banks were also generally responsible for the regulation and licencing of factoring and finance, basing the MLF on a registry system might incentivise central banks to promote and implement the instrument.

210. *Mr Richard Kohn (SFN)* agreed that the MLF should adopt a registration-based priority system in order to perform its role as a transitional instrument towards a comprehensive secured transactions reform based on the Secured Transactions Model Law.

211. *Mr Murat Sultanov (IFC)* agreed that the MLF should adopt a registration-based priority system. He explained that Palestine and Jordan were examples of States that had introduced financial leasing laws which subsequently facilitated acceptance of broader secured transactions reforms with registration-based priority systems.

212. *Mr Ammar Al-Saleh (EBRD)* noted that registration-based systems were preferable. He suggested that leasing, factoring and secured transaction reforms could be undertaken in parallel and if done correctly would support each other.

213. *The Chair summarised the discussion. The Working Group agreed that the MLF should adopt a registration-based priority system. The Working Group further agreed that the system should be designed to prevent the emergence of a separate registry for secured transactions. The Working Group noted that further discussion was required on the role of debtor notification/consent on matters unrelated to third party effectiveness.*

iii. Proceeds

214. *The Chair* opened the floor for comments on how the MLF should address proceeds. He queried whether Article 19 of the Secured Transactions Model Law could be adapted to the factoring context.

215. *Mr Michel Deschamps* suggested that the issue was whether the MLF should deal with competing claims between an assignee and an inventory financier that had an entitlement to a receivable or an assignee and another secured creditor that had an entitlement to the proceeds. He

suggested that it was difficult to decide on how the MLF should attempt to deal with perfection and priority with respect to proceeds between an assignee and another claimant. He concluded that the treatment of proceeds was not challenging, it was only where there was a priority dispute with other types of creditors where issues arose.

216. *Mr Neil Cohen* noted that there were several aspects to the proceeds issue. First, he noted that receivables could be the proceeds of something else. He suggested that because the MLF was an instrument of limited scope, it would necessarily have some borderline overlap issues with other instruments. In this case, it was inevitable that the MLF would have to address the overlap with the law creating the initial interest that had generated the receivables. Second, he noted that there was the treatment of the proceeds of receivables. He suggested that this issue could be addressed by the approach reflected in Article 22 in the FCI Model Law. He identified one other complexity where receivables that had been generated by the sale of goods were subsequently returned because of problems with the sale. He noted that if the returned goods which extinguish the receivables were proceeds, further overlap issues would exist.

217. *Mr Ulrich Brink (FCI)* noted that Mr Cohen had illustrated the difficulties in blending the MLF with the broader legal system in an implementing State. He noted that there would be necessary interfaces between the MLF and the State's secured transactions law and that the MLF could not solve every possible overlap issue. He suggested that the commentary should identify such overlaps and provide guidance to legislators about how such overlaps could be resolved.

218. *Ms Louise Gullifer* identified another possible issue related to proceeds of receivables. She explained that issues could arise where a creditor was given security through a floating charge over multiple assets. Under the secured transactions laws, the debtor would be able to dispose of proceeds in the ordinary course of business, whereas any factoring proceeds could not be disposed of and would be hermetically sealed. She cautioned that the MLF should not cover the whole financing arrangement, only the receivables.

219. *The Chair summarised the discussion. The Working Group identified a number of issues associated with the treatment of proceeds but was not yet in a position to make any final decisions as to how the MLF should treat proceeds.*

iv. Conflict of Laws

220. *The Chair* opened the floor for comments on how the MLF should address conflict of laws issues.

221. *Ms Catherine Walsh* suggested that it was necessary for the MLF to contain a set of conflict of laws provisions. She explained that with the increasing prevalence of cross border finance, parties would need certainty as to which State's registry they would need to register assignments in.

222. *Mr Michel Deschamps* agreed with Ms Walsh. He said that the absence of conflict of laws provisions in the MLF would create additional costs and uncertainty for parties.

223. *Mr Marek Dubovec (NatLaw)* agreed that conflict of laws rules were needed in the MLF. He explained that in States without reformed secured transactions laws, courts often had to rely on the conflict of laws rules for tangible assets contained in their civil codes, which did not operate well when applied to cross-border receivables financing. Even in many States that had undertaken reforms to their secured transactions laws, the new laws often lacked conflict of laws rules, which left a significant gap in the legal framework.

224. *Mr Neil Cohen* noted that conflict of laws issues would exist regardless of whether the MLF addressed it explicitly, as many transactions would involve either the receivable being international (where the assignor and the debtor were in different States) or a cross border assignment, or both. He explained that issues often arose where States did not differentiate in their law between bilateral contract conflict of laws rules (the rights between the two parties in contractual privity with one another) and conflict of laws rules governing third party effectiveness. He noted that during the negotiation of the Receivables Convention, representatives from ratings agencies explained that when they were trying to assess transactional risk, the most difficult issue was conflict of laws because the ratings agencies could not have confidence in which rule the court would apply if an issue arose. As a result, ratings agencies had to take a conservative approach and applied the domestic law rule that would create the most transactional risk. He concluded that a *de facto* assumption of the worst case scenario in applying domestic law rules increased the cost of credit and that the MLF could remedy this situation by providing conflict of laws provisions that would clarify which laws would apply to a transaction.

225. The Chair queried whether the MLF should apply in circumstances where the debt was international or where the assignment was international.

226. *Mr Alejandro Garro* agreed that the MLF should comprehensively address conflict of laws issues. He noted that the conflict of laws rules in the instrument could be limited to the rules in Chapter V, although the Working Group might need to also consider the applicable law for formation of an agreement and perfection. In response to the Chair's question, he suggested that the MLF should apply in circumstances where the receivable was international or where the assignment was international.

227. *Mr Michel Deschamps* suggested that the MLF should have rules that state what the applicable law would be and that the instrument should not restrict the scope of conflict of laws rules to international assignments. He noted that the Receivables Convention restricted the application of its conflict of laws rules to international assignments, whereas the Secured Transactions Model Law, the UCC and many State's PPSAs provided conflict of laws with a general scope of application.

228. *MS Catherine Walsh* agreed with Mr Deschamps and suggested that the conflict of laws rules in the Secured Transactions Model Law would be a preferable starting point for the MLF. She noted that the Secured Transactions Model Law provided rules dealing with the law on applicable rights and obligations between assignor and assignee, between assignee and debtor and rules on validity, 3rd party effectiveness and priority. She recommended that the MLF would need to include points on all of these issues, and that the MLF could replicate the approach of the Secured Transactions Model Law as UNCITRAL had dedicated significant time to developing those rules.

229. *The Chair summarised the discussion. The Working Group agreed that the MLF required a set of provisions governing conflicts of law. The Chair suggested that the Secretariat work intersessionally with Working Group members that specialised in conflict of laws to develop a first draft of the conflict of laws rules.*

Item 4: Organisation of future work

230. *Mr William Brydie-Watson (UNIDROIT)* noted that UNIDROIT was looking to schedule the second Factoring Working Group session between either 30 November – 2 December 2020 or 14 – 16 December 2020. He explained that it was anticipated that the second session would be a full three day in-person meeting at the UNIDROIT headquarters in Rome. Experts were encouraged to attend in person, although participants that could not travel would be able to participate via videoconference.

231. Several Working Group members noted that the earlier dates would conflict with academic teaching dates and indicated a preference for the later dates. Other Working Group members noted that the later dates could require participants to quarantine over the end of year holiday period back in their home States and indicated a preference for the earlier dates. *The Secretariat* noted that it would consult with Working Group members in finalising the dates for the second session.

Item 5: Any other business

232. *The Chair* opened the floor for any final comments from participants.

233. *Mr Bob Trojan (NatLaw)* suggested that the MLF should take into account UNIDROIT and UNCITRAL's work in the field of digital assets to ensure that the instrument would be well adapted to recent technological developments.

234. *Mr Bruce Whittaker* noted that the Working Group had not yet discussed the structure of the MLF and whether it should be aligned with the Factoring Convention, the Receivables Convention or the Secured Transactions Model Law. He also queried whether the instrument should address enforcement or the exercise of collection rights, which were covered by the Secured Transactions Model Law.

235. *Mr John Wilson (IFC)* suggested that it would be helpful if the instrument provided a set of general rules followed by sections with specific rules for different types of receivables financing. He noted that this approach was consistent with the structure of the Secured Transactions Model Law.

236. *The Chair* recalled that while there had been agreement on the format of the instrument in providing a set of black letter rules with limited explanation and commentary, the Working Group had not yet agreed on a structure. He suggested that this matter could be addressed at the next meeting once the Working Group had an updated set of documents to consider.

237. *Mr Murat Sultanov (IFC)* queried whether the Working Group should consider how the MLF could be adapted to accommodate Sharia law principles. He noted that the IFC had been assisting the UAE in developing a reverse factoring platform. To accommodate Islamic banks, the platform would be Sharia compliant by allowing tangible property rights to be transferred in exchange for the provision of finance. He suggested that it would not be possible to develop a MFL that was complaint with Sharia law, however it might be worth addressing in the commentary how the instrument could be adapted to accommodate Sharia law. He explained that the Model Law on Leasing had included broad freedom of contract rules that allowed parties to derogate from many rights and obligations which allowed the instrument to be more compliant with Sharia law.

238. *Mr Ignacio Tirado (UNIDROIT)* agreed that including further information on how the MLF could be adapted to Sharia law could expand the appeal of the instrument. He encouraged the World Bank Group to share its expertise on these matters in reviewing the MLF once a first draft of the instrument had been developed.

239. *The Chair* agreed that further analysis on the relationship between the MLF and Sharia law would be useful, however he cautioned that unduly increasing the freedom for parties to derogate from the instrument could negatively affect third party rights.

240. *Mr Neil Cohen* noted that the Working Group would need to balance the comprehensiveness of the MLF with ensuring the product would be simple and attractive for States considering implementation.

241. *Mr Marek Dubovec (NatLaw)* agreed that it would be preferable for the MLF to contain clear rules rather than comprehensive rules that might be technically more complete and correct but were overly complex. He noted that the draft instrument would need to include rules on issues that the Working Group had not yet discussed, such as enforcement and party autonomy. In relation to party autonomy, he explained that the Factoring Convention allowed parties to opt out of the entire application of the convention, an approach which would probably not be advisable for the MLF.

242. *Mr Michel Deschamps* agreed that it was important for the MLF not to be overly complex and should adhere to the KISS principle: "keep it simple, stupid".

243. *Mr Ignacio Tirado (UNIDROIT)* explained that enforcement involved challenging issues related to national procedural law and suggested that the Working Group be cautious in addressing enforcement issues in the MLF. He noted that UNIDROIT was undertaking a separate project to develop principles of effective enforcement.

244. *Mr Jae Sung Lee (UNCITRAL)* noted that UNCITRAL was pleased with how the Working Group documents represented UNCITRAL instruments and how the Working Group was taking into account relevant UNCITRAL instruments in their discussions. He noted that UNCITRAL would be pleased to assist in preparing a comparative analysis with UNCITRAL instruments once the first draft of the MLF had been prepared.

Item 6: Closing of the session

245. *The Chair* thanked all participants for their contributions to what had been a friendly, constructive and productive first session.

246. *The Chair declared the session closed.*

ANNEX I

AGENDA

1. Opening of the session by the Chair

2. Adoption of the agenda and organisation of the session

3. Consideration of matters identified in Issues Paper (Study LVIII A – W.G.1 – Doc. 2)

   (a) Preliminary matters
   (b) Scope of the Model Law
   (c) Content and structure of the Model Law

4. Organisation of future work

5. Any other business

6. Closing of the session

ANNEX II

LIST OF PARTICIPANTS

EXPERTS

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	Mr Jae SUNG LEE Legal Officer International Trade Law Division
	Ms Tian Shu Liu Intern
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	Mr John WILSON Senior Financial Sector Specialist

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