

## SyCipLaw Banking, Finance and Securities Bulletin:

### **The Personal Property Security Act and its Implementing Rules and Regulations**

The Personal Property Security Act (“PPSA”) was enacted on August 17, 2018, to strengthen the secured transactions legal framework in the Philippines, and provide for the creation, perfection, determination of priority, establishment of a centralized notice registry, and enforcement of security interests in personal property (tangible and intangible), except aircraft and ships. The PPSA’s full implementation is conditioned upon the issuance of the relevant implementing rules and regulations and the establishment of a new registry (wherein security interests created under the PPSA may be registered). In this connection, the implementing rules and regulations of the PPSA (“PPSA Rules”) were published last November 18, 2019 and have become effective on December 3, 2019. However, the registry has not yet been established. Nevertheless, the PPSA Rules directed the Land Registration Authority to establish the registry within six months from the publication of the PPSA Rules.

The PPSA expressly repealed, amended or modified, among others, the provisions of the Chattel Mortgage Law (Act No. 1508) (specifically, Sections 1-16), the provisions of the Civil Code of the Philippines (Republic Act No. 386) (“Civil Code”) on mortgage and pledge (specifically, Articles 2085-2123, 2127, 2140-2141, 2241, 2243 and 2246-2247), and the registration of chattel mortgages under the Property Registration Decree (Presidential Decree No. 1529) (specifically, Sections 114-116).

Before the PPSA, the creation of a valid security interest over personal property under Philippine law is governed by the Civil Code and the Chattel Mortgage Law. Under the PPSA Rules, however, all security interests created from February 9, 2019 to the PPSA’s full implementation when the registry is established and operational (the “**Transitional Period**”) will be governed by the PPSA except that registration will be in accordance with the Chattel Mortgage Law until the registry is established. Once the registry is established, the creation of a valid security interest over personal property under Philippine law will be entirely governed by the PPSA and the PPSA Rules, except interests in aircraft which are subject to the Civil Aviation Authority Act of 2008 (Republic Act No. 9497) and interests in ships which will continue to be governed by the Ship Mortgage Decree of 1978 (Presidential Decree No. 1521).

### **Creation of Security Interest**

Under the PPSA Rules, parties are free to enter into any form of security arrangements over moveable property as long as the security arrangement is not inconsistent with the PPSA or the PPSA Rules. Further, subject to existing law, parties may also apply the PPSA Rules to other functional equivalents of security interest, including fiduciary transfers of title; financial lease; assignment or transfer receivables; and sale with retention of title. A security interest may be created by (i) a security agreement, (ii) an operating lease for not less than one year, or (iii) the sale of an account receivable (unless otherwise stipulated by the parties in the document of sale).

Except as otherwise provided in the PPSA, the PPSA Rules, or upon agreement of the parties, a security interest will continue in the collateral notwithstanding the sale, lease, license, exchange, or other disposition of the collateral.

A security interest is extinguished when all secured obligations have been discharged and there are no outstanding commitments to extend the credit secured by the security interest.

## *Security Agreement*

The security agreement must be contained in a written contract signed by the parties and must identify the collateral and the secured obligation. The description of the collateral is considered sufficient (whether it is specific or general) if it reasonably identifies the collateral. For example, a description such as “all personal property” of the grantor is sufficient. The security agreement must provide for the language to be used in agreements and notices.

The security agreement may provide for the creation of a security interest in a *future property* or *after-acquired asset*, but it is created only when the grantor acquires rights in it or the power to encumber it. The security agreement may also provide that a security interest in a tangible asset that is transformed into a *product* extends to the product (but limited to the value of the encumbered asset before it became part of the product). It may likewise provide that a security interest in a tangible asset extends to its *replacement* (but limited to the value of the encumbered asset before it was replaced).

## **Perfection of Security Interest**

After a security interest has been created, it may be perfected by: (i) *registration* of a notice with the registry, (ii) *possession* of the collateral by the secured creditor, and (iii) *control* of investment property and deposit account. On perfection, a security interest becomes effective against third parties.

A security interest in any *tangible asset* may be perfected by registration (*i.e.*, by filing a notice with the registry) or possession (whether actual or constructive). While a security interest in *investment property* or *deposit account* may be perfected by registration or control (*i.e.*, through (i) the creation of a security interest in favor of the deposit-taking institution or intermediary, (ii) the conclusion of a control agreement (which must be executed under oath and must include the date and time of execution), or (iii) for investment property that is an electronic security but not held with an intermediary, the notation of the security interest in the books of the issuer).

## **Registry during the Transitional Period**

Under the PPSA Rules, the Land Registration Authority (“**LRA**”), within six months from the publication of the PPSA Rules, will establish and administer the centralized, nationwide registry. The registry must provide electronic means for registration and search of notices. The LRA will issue the necessary guidelines on the use and management of the registry.

During the Transitional Period, the registration of the security agreement with the LRA will be in accordance with the Chattel Mortgage Law. The LRA will also determine a system of provisional registration of such agreements during such Transitional Period. This said, given that the PPSA repealed

the provisions of the Chattel Mortgage Law, the legal effect of registration under such law as provided in the PPSA Rules is unclear.

## **Priority of Security Interest**

The PPSA provides for priority rules (*i.e.*, rules to determine which secured creditor will have priority over the same collateral). Generally, the priority of security interests and liens in the same collateral will be determined *according to time of registration of a notice or perfection by other means*, without regard to the order of creation of the security interest and liens or (except as expressly stipulated in the PPSA Rules) to the mode of perfection. For details, please see Chapter 4 of the PPSA and Rule VI of the PPSA Rules.

If the grantor has become insolvent, the security interest perfected before the commencement of insolvency proceedings in respect of the grantor will remain perfected and retain the priority it had before the commencement of the proceedings, subject to applicable insolvency law.

## **Enforcement of Security Interest**

The secured creditor may enforce its security through, among other modes of enforcement, the following: (i) judicial process or (ii) extra-judicial process, including (a) the sale of the secured assets through public or private disposition or (b) retention of collateral.

Any judicial enforcement of securities, including disposition of collateral, will be governed by rules promulgated by the Philippine Supreme Court.

### *Taking Possession of the Collateral*

If the collateral is *not* with the secured creditor, upon default, the secured creditor may take possession of the collateral without a judicial process if the security agreement so stipulates, but possession must be without breach of the peace. In this connection, “breach of the peace” includes entering the private residence of the grantor without permission, resorting to physical violence or intimidation, or being accompanied by a law enforcement officer when taking possession or confronting the grantor.

If the secured creditor cannot take possession of the collateral without breach of the peace, the secured creditor may proceed as follows:

1. The secured creditor will be entitled to an expedited hearing upon application with the court for an order granting the secured creditor possession of the collateral.
2. The secured creditor must provide the debtor, grantor, and, if the collateral is a fixture, any real estate mortgagee, a copy of the application with supporting documents and evidence.
3. The secured creditor is entitled to an order granting possession of the collateral upon the court finding that a default has occurred under the security agreement and that the secured creditor has a right to take possession of the collateral.

Under the following special cases, upon default, the secured creditor may take possession of the collateral without judicial process by:

1. instructing the account debtor of an accounts receivable to make payment to the secured creditor, and apply such payment to the satisfaction of the obligation secured by the security interest after deducting the secured creditor's reasonable collection expenses;
2. in a negotiable document where the security interest is perfected by possession, proceeding as to the negotiable document or goods covered by the negotiable document;
3. in a deposit account maintained by the secured creditor, applying the balance of the deposit account to the obligation secured by the deposit account; and
4. in other cases of a security interest in a deposit account perfected by a control agreement, instructing the deposit-taking institution to pay the balance of the deposit account to the secured creditor's account by providing (i) a copy of the security agreement and (ii) the secured party's affidavit, stating that a default has occurred and that the secured party is entitled to enforce the security interest non-judicially.

### *Disposition of Collateral*

After default, a secured creditor may (upon prior notice to the grantor, other secured creditors, and any other person from whom the secured creditor received notification of a claim of interest in the collateral) sell or otherwise dispose of the collateral, publicly or privately, in its present condition or following any commercially reasonable preparation or processing. A disposition is commercially reasonable if the secured creditor disposes of the collateral in conformity with commercial practices among dealers in that type of property.

The specific guidelines on private or public disposition are set out in Section 7.09 of the PPSA Rules.

### *Retention of Collateral*

After default, a secured creditor may also propose to the debtor and grantor to take all or part of the collateral in total or partial satisfaction of the secured obligation by sending a *proposal* to the grantor, other secured creditors, and any other person from who the secured creditor received notification of a claim.

The secured creditor may retain the collateral in case of: (i) a proposal for the acquisition of the collateral in full satisfaction of the secured obligation, without objection from any of the addressees of the proposal; or (ii) a proposal for the acquisition of the collateral in partial satisfaction of the secured obligation, but only if the secured creditor received the written affirmative consent of the addressees of the proposal.

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If you require any advice or information, please contact SyCipLaw using the following contact details:

**SyCip Salazar Hernandez & Gatmaitan**

SyCipLaw Center, 105 Paseo de Roxas

Makati City 1226, The Philippines

t: +632 8982 3500; +632 8982 3600; +632 8982 3700

f: +632 8817 3145; +632 8817 3896

e: [sshg@syciplaw.com](mailto:sshg@syciplaw.com)

[www.syciplaw.com](http://www.syciplaw.com)