

# **CURRENT LEGAL REGULATIONS ON SECURITY FOR PERFORMANCE OF OBLIGATIONS WITH INVENTORY**

**National Registration Agency for Secured Transactions, Ministry of Justice**

The robust growth of the economy has inevitably entailed the demand to access increasingly larger capital sources by production and business chain actors, accelerating the development of financial institutions in the capital supply chain with requirements on transparency and legal safety. To meet these requirements, Vietnamese legal system in general and the legal institutions on performance of secured obligations in particular are increasingly being improved to be in line with the civil transaction practices, ensuring safety of capital financing, not only depending on traditional collateral such as real estate but also utilizing economic values of other assets to secure the performance of obligations, including inventory.

However, in practice, the security for performance of obligations with inventory, especially the mortgage of inventory, still faces certain difficulties due to the nature of the asset itself, which is continually circulatory during the securing party's operations, and due to the specific regulations on security for performance of obligations with this type of collateral. In order to better identify the current legal framework for security for performance of obligations with inventory in Vietnam, this presentation introduces the current Vietnamese legal regulations on the same, at the same time raising a number of issues to be discussed so as to further study and improve the law as well as making some recommendations on practical implementation.

## **I. Regulations in Vietnam's civil code on security for performance of obligations with inventory**

### ***1. Legal basis:***

- Civil Code (CC) 2015;
- Decree No. 21/2021/ND-CP dated March 19, 2021 of the Government providing for the implementation of the Civil Code on security for performance of obligations (Decree No. 21/2021/ND-CP);
- Circular No. 39/2016/TT-NHNN providing for customer lending operations of credit institutions, foreign bank branches;
- Law on Product and Goods Quality 2007 (amended and supplemented in 2018); the decrees detailing the implementation of a number of articles of the Law on Product and Goods Quality.

### ***2. Contents of regulations on security for performance of obligations***

Prior to the effective date of the 2005 Civil Code, the mortgage of assets was only applicable to real estate collateral (Article 346 of 1995 Civil Code). The use of inventory to secure the performance of obligations was applicable only in pledge, deposit, and collateral security; however, the application of these transactions to inventory caused a loss of its cyclical behavior.

It wasn't until the 2005 Civil Code and then 2015 Civil Code came into force that the legal mechanism applied to security for performance of obligations with inventory became more flexible and was more suitable to recognize the mechanism for application of mortgage of inventory<sup>1</sup> as a "special case" in mortgages.

Being recognized by the Civil Code, the mortgage of inventory has also been provided for and guided in relevant legal documents, including the following noteworthy contents:

### **2.1. Regarding inventory used to secure the performance of obligations**

Inventory used to secure the performance of obligations:

(i) It can be existing assets or assets formed in the future owned by the securing party, except for liens on assets or retention of title; not prohibited by the Civil Code or other relevant laws from the transfer of ownership rights at the time of entering the security contracts, creating the security interests;

(ii) It can be commodity in warehouse (in static state), inventory (in dynamic state) and including rights to claim payment from buyers, proceeds, assets formed from the proceeds, assets to be replaced or exchanged;

(iii) It may have a value greater than, equal to, or less than the value of the secured obligation;

(iv) It can be generally described, but must be identifiable.

Compared with the definition in the former Decree guiding the Civil Code - Decree No. 163/2006/ND-CP dated December 29, 2006 of the Government on secured transactions (amended and supplemented with Decree No. 11/2012/ND-CP) in Clause 8, Article 3, "Inventory are movable assets used for exchange, purchase, sale or lease within the scope of production and business operations of the securing party", the provisions in Decree No. 21/2021/ND-CP are clearer, covering the practical situations related to the security for performance of obligations with this type of assets. Besides, the definition introduced by Decree No. 163/2006/ND-CP was basically included in the definition of collateral in Article 295 of 2015 Civil Code, thus it should not be re-defined.

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<sup>1</sup> According to 2005 Civil Code, "Mortgage of assets means the use by one party (hereinafter referred to as the mortgagor) of assets under its ownership as security for the performance of a civil obligation towards the other party (hereinafter referred to as the mortgagee) and does not deliver such assets to the mortgagee..." (Clause 1, Article 342).

According to 2015 Civil Code, "Mortgage of assets means the use by one party (hereinafter referred to as the mortgagor) of assets under its ownership as security for the performance of an obligation to the other party without delivering such assets to such party (hereinafter referred to as the mortgagee)..." (Clause 1, Article 297).

Legal basis: Article 295<sup>2</sup>, Clause 4, Article 321<sup>3</sup> Civil Code 2015; Clause 1 Article 8<sup>4</sup>, Article 19<sup>5</sup> Decree No. 21/2021/ND-CP.

## **2.2. Regarding the description of collateral as inventory**

Current Vietnamese law includes pretty adequate regulations on the description of inventory collateral, including:

According to the 2015 Civil Code, inventory collateral can be described in general, but must be identifiable. Allowing a general description of collateral is necessary and in line with the practice of entering and performing security contracts and security interests, especially with the description of inventory – the type of assets that changes often in terms of quantity, type and value; helping the parties to the inventory mortgage avoid trouble, incur additional costs to agree on re-description of the collateral any time of changes of the asset. However, apart from the allowing of general description, Vietnamese law also sets limits on the description of collateral when requiring that the description must ensure the identification of the collateral to assist in the disposal of collateral in an accurate manner, avoiding legal disputes during the process.

Besides, to guide the implementation of 2015 Civil Code, Decree No. 21/2021/ND-CP includes provisions to better clarify the description of inventory collateral, whereas inventory can be described in terms of asset value or types of goods.

Legal basis: Clause 2, Article 295<sup>6</sup> Civil Code 2015, Article 19 Decree No. 21/2021/ND-CP.

## **2.3. Regarding the rights of the securing party, the secured party**

The rights of the securing party and the secured party in securing the performance of obligations with inventory shall comply with the provisions of the 2015 Civil Code, guidelines in Decree No. 21/2021/ND-CP and other relevant laws, including the cases of mortgage of inventory:

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### **<sup>2</sup> Article 295. Collateral**

“1. The collateral must be owned by the securing party, except for the cases of lien on assets or retention of title.

2. The collateral may be described in general, but must be identifiable.

3. The collateral can be existing assets or assets formed in the future.

4. The value of the secured assets may be greater than, equal to, or less than the value of the secured obligation.”

<sup>3</sup> The securing party may sell, replace or exchange the collateral, if it is inventory. In this case, rights to claim payment from the buyer, proceeds, assets formed from the proceeds, assets to be replaced or exchanged shall become the collateral.

<sup>4</sup> Assets used to secure the performance of an obligation includes: Existing assets or assets to be formed in the future, except for cases where they are prohibited by the Civil Code, other relevant laws to be traded, assigned, or otherwise transferred of ownership rights at the time of entering the security contracts or creating the security interests;

<sup>5</sup> Inventory and warehouses used to secure the performance of obligations may be described in terms of asset value or types of goods. The description of a warehouse being shall show the signs of the warehouse location such as addresses, warehouse numbers (if any).

Inventory may be goods in warehouses or goods in the course of business.

<sup>6</sup> The collateral may be described in general, but must be identifiable.

3.1. The mortgagor may sell, replace or exchange the mortgaged assets which is inventory without consent of the mortgagee and without having to notify the mortgagee; meanwhile, for mortgage of other assets, the mortgagor may only sell, exchange, or donate the mortgaged assets upon agreement by the mortgagee or as prescribed by law. This is not a new regulation but is inherited and developed from the provisions of the 2005 Civil Code, which is a “privilege” reserved only for the mortgagor of inventory; in line with the often circulatory and flexible nature of this type of asset<sup>7</sup>.

3.2. The mortgagee has the general rights provided for by the 2015 Civil Code, including: (i) Examine and inspect directly the collateral provided that such examination and inspection does not hinder or cause difficulty to the use and exploitation of the collateral; (ii) require the mortgagor to provide information on the current status of the collateral; (iii) require the mortgagor to apply necessary measures to preserve the assets and the value of assets in the event of a risk of loss of value or depreciation in value of the assets due to its exploitation and use; (iv) conduct the registration of mortgage as prescribed by law; (v) require the mortgagor or a third person holding the collateral to deliver it to the mortgagee if the mortgagee fails to perform or incorrectly performed the obligations; (vi) hold documents related to the collateral as agreed by the parties, unless otherwise provided for by the law; (vii) realize the collateral upon the availability of grounds provided for in the Civil Code. To specify these rights in the 2015 Civil Code on the realization of collateral, Decree No. 21/2021/ND-CP provides for the right to directly examine and inspect the collateral to prevent the dispersing of collateral, for the realization by the secured party; also provides for the obligations of the securing party, the person holding the collateral related to the secured party’s exercise of this right.

Besides, where the mortgage of inventory has been registered, giving rise to its effective against the third party, the mortgagee is entitled to reclaim the collateral and to establish a payment priority order in compliance with the Civil Code. Of which, with respect to the right to pursue the collateral, the mortgagee shall not apply the right to pursue the inventory that have been sold, replaced or exchanged, in which case the mortgagee shall be entitled to exercise the right to reclaim of the right to claim payment from the buyer, the proceeds, the assets formed from the proceeds, the assets replaced or exchanged as a result of the sale, exchange, or replacement of the collateral which is inventory.

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<sup>7</sup> According to the 2005 Civil Code, the mortgagor “May sell or replace the inventory collateral. In case of sale of inventory collateral, the right to claim payment from the buyer, proceeds, or assets formed from the proceeds shall become the collateral to replace the sold assets. (Clause 3 Article 349).

According to the 2015 Civil Code, the mortgagor “May sell, replace or exchange the inventory collateral. In this case, claim payment from the buyer, proceeds, or assets formed from the proceeds, the replaced or exchanged assets shall become the collateral.” (Clause 4, Article 321)

Legal basis: Article 297<sup>8</sup>, Clause 4, Article 321<sup>9</sup>, Article 323<sup>10</sup> Civil Code 2015; Sub-clause b, Clause 2, Article 7<sup>11</sup>, Clauses 6, 7, 8 Article 52<sup>12</sup> Decree No. 21/2021/ND-CP.

## **II. Legal provisions on registration of and provision of information on security interests**

### **1. Legal basis:**

- Civil Code 2015;
- Law on Access to Information 2016;
- Decree No. 102/2017/ND-CP dated September 1, 2017 of the Government providing for the registration of security interests (Decree No. 102/2017/ND-CP);
- Circular No. 08/2018/TT-BTP dated June 20, 2018 (amended and supplemented with Circular No. 06/2020/TT-BTP dated December 17, 2020) of the Minister of Justice guiding a number of issues on registration of and provision of information on security interests, contracts, and exchange of information on registration of security interests at the Centers for Registration of Transactions and Assets of the National Registration Agency for Secured Transactions, Ministry of Justice.

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#### <sup>8</sup> **“Article 297. Effectiveness against third parties**

1. A security interest shall take effect against a third party from the time of registration of such security interest or the secured party holds or possess the collateral.
2. When the security interest takes effect against a third party, the secured party is entitled to reclaim the collateral and the payment prescribed in Article 308 of this Code and relevant laws.”

<sup>9</sup> Sell, replace, or exchange or exchange the collateral, if it is inventory. In this case, rights to claim payment from the buyer, proceeds, assets formed from the proceeds, assets to be replaced or exchanged shall become the collateral.

#### <sup>10</sup> **Article 323. Rights of mortgagees**

1. Examine and inspect directly the collateral provided that such examination and inspection does not hinder or cause difficulty to the use and exploitation of the collateral.
2. Require the mortgagor to provide information on the current status of the collateral;
3. Require the mortgagor to apply necessary measures to preserve the assets and the value of assets in the event of a risk of loss of value or depreciation in value of the assets due to its exploitation and use;
4. Conduct the registration of mortgage as prescribed by law;
5. Require the mortgagor or a third person holding the collateral to deliver it to the mortgagee if the mortgagee fails to perform or incorrectly performed the obligations;
6. Hold documents related to the collateral as agreed by the parties, unless otherwise provided for by the law;
7. Realize the collateral upon the availability of grounds provided for in the Civil Code.

<sup>11</sup> The secured party's right to reclaim the collateral shall not apply to the collateral that has been sold, replaced, or exchanged in compliance with the provisions in clause 5 Article 321 of the Civil Code.

#### <sup>12</sup> **Article 52. Handing over of collateral, realization of pledged or mortgaged assets**

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6. In case the securing parties or persons holding the assets fail to hand over the collateral, the secured parties have the rights to examine and inspect the collateral to prevent dispersion of collateral, to realize or to request courts for resolution.
7. In case the persons holding the collateral are third parties, the securing parties and persons holding the collateral shall be responsible to cooperate with the secured parties in the examination and inspection of the collateral.
8. The securing parties or persons holding the collateral that fail to hand over the collateral as agreed, fail to hand over the collateral in compliance with Article 301 of the Civil Code, fail to cooperate or obstruct the examination and inspection of the collateral thereby causing damages to the secured parties must compensate for the damages.

## **2. Procedures for registration and provision of information**

### ***2.1. Regarding the authority to register and provide information***

The agency competent to register the mortgage of inventory is the Transaction and Assets Registration Center of the National Registration Agency for Secured Transactions under the Ministry of Justice.

Legal basis:

- Clause 4, Article 9, Decree No. 102/2017/ND-CP<sup>13</sup> dated September 1, 2017 of the Government on registration of security interests;

- Clause 3, Article 6, Circular No. 08/2018/TT-BTP<sup>14</sup> dated June 20, 2018 of the Minister of Justice guiding a number of issues on registration of, providing information on security interests, contracts and exchanging information on registration of security interests at Centers for Registration of Transactions and Assets of the National Registration Agency for Secured Transactions under the Ministry of Justice.

### ***2.2. Regarding procedures for registration of security interests***

#### ***a) Means of filing application for registration***

The filing of application for mortgage of inventory shall be conducted via one of the following means: (i) online; (ii) direct filing at the Center for Registration of Transactions and Assets; (iii) by post; (iv) by email where the applicant has been granted with a code to use the database on security interests.

In case the registration of mortgage of inventory is conducted online, the applicant uses the database usage code, the granted online registration account to access to the online system to register the security interests. The online registration system confirms the result of security interest registration on the system interface, and at the same time, the registration agency sends 01 document certifying the registration result to the applicant via one of the above-mentioned means.

Legal basis: Article 13<sup>15</sup>, Article 56<sup>16</sup> Decree No. 102/2017/ND-CP.

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<sup>13</sup> Centers for Registration of Transactions and Assets of the National Registration Agency for Secured Transactions under the Ministry of Justice (hereinafter referred to as registration centers) shall register and provide information on security interests with movable assets and other assets not under registration competence of the Civil Aviation Authority of Vietnam, Vietnam Maritime Administration (or the Maritime Administration Branches, the Maritime Port Authority), Land Registration Office (or Land Registry Office Branches).

<sup>14</sup> Collateral is registered at the Centers for Registration of Transactions and Assets as required includes: "...Machinery, equipment, production lines, raw materials, materials, consumables, other goods, precious metals, precious stones...".

<sup>15</sup> **Article 13. Means of filing application for registration of security interests**

1. Online;
2. Direct filing;
3. By post;
4. By email where the applicant has been granted with a code to use the database on security interests."

<sup>16</sup> **Article 56. Online registration procedures**

"The online registration of a security interest is conducted in accordance with the following procedure:

1. The applicant uses the database usage code, the granted online registration account to access to the online system to register the security interests on the online registration interface;

*b) Regarding description in the registration*

The registration applicant, the person conducting the registration of the inventory collateral may describe the assets with commodity name, type, quantity, or other information related to such commodity; where the collateral is motor vehicles which are inventory, the applicant and the person performing the registration shall not be required to describe the vehicle's chassis number on the interactive electronic form on the online registration system, but shall describe the collateral as “inventory” in the “Collateral Description” section on the Registration Form or the “Description” field on the Interactive Electronic Form on the online registration system.

The registration agency shall register in accordance with the principle of recording the registration contents with the information declared on the Registration Form. The securing party and the secured party shall be responsible to the law for the legality and accuracy of information about the securing party and the collateral declared on the Registration Form.

Legal basis: Clause 2, Article 7 of Decree No. 102/2017/ND-CP; sub-clause a, sub-clause b clause 2 Article 10<sup>17</sup> Circular No. 08/2018/TT-BTP.

*c) Regarding registration of changes*

Where the mortgage of inventory has been registered, upon any changes in the collateral due to production or business operations, the applicant is not required to register for the change. Besides, where the collateral is an asset formed in the future that has already been formed and such assets are inventory, the registration for changes is not required.

Legal basis: Clause 4, Article 18<sup>18</sup>, Clause 3, Article 52<sup>19</sup> Decree No. 102/2017/ND-CP.

**2.2. Regarding provision of information about security interests**

*a) Right to request for information provision*

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2. The online registration system confirms the result of security interest registration on the online system interface;

3. The registration agency sends 01 certificate of the registration result certified by the registration agency to the applicant via one of the means specified in Article 17 of this Decree.”

<sup>17</sup> “Where the collateral is inventory, the registration applicant, the person conducting the registration may describe the assets as follows:

a) Commodity name, type, quantity, specific address of warehouse or other information related to such commodity;

b) Where the collateral is motor vehicles which are inventory, the applicant and the person performing the registration shall not be required to describe the vehicle's chassis number on the interactive electronic form on the online registration system, but shall describe the collateral as “inventory” or “assets formed in the future” in the “Collateral Description” section on the Registration Form or the “Description” field on the Interactive Electronic Form on the online registration system;”

<sup>18</sup> Collateral is assets formed in the future that have already been formed, except for cases the security assets formed in the future are inventory.

<sup>19</sup> Where a security interest has been registered with respect to inventory collateral, when such collateral changes due to production or business operations, the registration applicant shall not have to register for changes.

Individuals and organizations have the right to inquire about or request for information about security interests stored in the register, database on security interests, and the national data system on security interests.

Legal basis: Clause 3, Article 106<sup>20</sup> Civil Code 2015; Article 5<sup>21</sup> Law on Access to Information; Clause 1, Article 59 of Decree No. 102/2017/ND-CP.

*b) Means of requesting for information*

Individuals, organizations, and agencies shall send a written request for information provision to the Centers for Registration of Transactions and Assets of the National Registration Agency for Secured Transactions under the Ministry of Justice via one of the following means:

- (i) Via the online registration system;
- (ii) Direct filing;
- (iii) By post;
- (iv) By email where the applicant has been granted with a code for use of the database on security interests.

Legal basis: Article 13, Article 60 of Decree No. 102/2017/ND-CP.

*b) Procedures for provision of information*

After receiving a valid information request form, the person conducting the registration shall look up information in the register or database on security interests; provide information in writing to the requester within the day of receipt of the request form; if the request form is received after 15:00, the information provision shall be completed within the next working day; where it is necessary to extend the required processing time, it shall not exceed 03 working days.

The return of results of information provision shall be conducted via one of the following means:

- (i) Directly at the registrar.
- (ii) By post;
- (iii) Other means to be agreed upon by the registration agency and the registration applicant.

Legal basis: Articles 16,17, and 62 Decree No. 102/2017/ND-CP.

### **III. A number of issues to be discussed or experiences to be consulted related to security for performance of obligations with inventory**

#### **1. Regarding description of inventory collateral**

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<sup>20</sup> The registration of assets must be publicly disclosed.

<sup>21</sup> Citizens are entitled to access information of state regulators, except for information not allowed to access as specified in Article 6 of this Law; entitled to conditional access to information specified in Article 7 of this Law.



As mentioned in Section I.2, when entering a security contract or creating a security interests with inventory, the inventory collateral may be described in general, but must be identifiable; can be described by assets value or by type of commodity. However, when registering a security interest with this type of assets, in order to ensure that there is sufficient information to be publicly disclosed and to be transparent about the collateral under the registered security interest, the law on registration of security interests includes its own recommendations on description on the Registration Form – as mentioned in Section II.3.

Therefore, in entering a security contract and creating a security interest with inventory, in order to comply with the law and to make it easy in the registration of security interest, apart from ensuring the description to be in compliance with the provisions of the 2015 Civil Code, Decree No. 21/2021/ND-CP, the securing party and the secured party also need to agree to describe the collateral in compliance with the law on registration of security interests. For example, if inventory are automobiles, motorbikes, or other road motorized vehicles, the asset description information must include the vehicles' chassis numbers.

## **2. Regarding risks when accepting inventory collateral**

There have been actual cases as follows:

- The same inventory are used to secure loans in many different banks, each bank describes the collateral differently. For example: Bank A describes the collateral in accordance with the commodity description on the customs declaration form and customs clearance decisions, Bank B describes the collateral as receivables...

- It is difficult for the mortgagee to manage and control the mortgagor's sale of inventory collateral because the transaction of this type of collateral in principle does not require the consent of the mortgagee.

According to current Vietnamese law, apart from Circular No. 39/2016/TT-NHNN dated December 30, 2016 of the State Bank of Vietnam providing for lending operations of credit institutions and foreign bank branches to customers, banks' internal regulations on lending are required to cover "the management, supervision, and monitoring of collateral in accordance with loan security interests, characteristics of the collateral and customers" (sub-clause d, clause 2, Article 22), yet there is no specific legal mechanism to govern the above problems, only support mechanisms to minimize legal risks of the secured party when accepting inventory as collateral by way of examining and inspecting the collateral, by reclaiming the collateral, etc. (as mentioned in section I.3.2) or the mechanism for registration of security interests as required to publicly disclose information and determine order of priority for payment. However, in order to further limit potential disputes, and to minimize both legal and economic risks, we would like to make the following recommendations in taking inventory as collateral:

- The mortgagee needs to register the security interest in order to make information public and transparent to the whole society, and to establish the order of

priority for payment in the realization of collateral. Of which, the collateral must be described in accordance with regulations so that it is identifiable.

- Credit institutions need to study to apply appropriate professional measures to control the circulation of collateral; with a mechanism for exchange of information among themselves to avoid the case of jointly accepting the same assets as collateral.

### **3. Regarding the distinction between mortgage of inventory (including commodity in stock) and mortgage of warehouses**

According to the current Civil Code, no specific concepts of inventory and warehouse are available; according to Decree No. 21/2021/ND-CP, inventory is only identified as commodity in stock or commodity in the production and business process.

The lack of a concept to make specific distinction leads to many disputes, many legal risks in practice, many cases of mortgage of commodity which is not clearly identified as inventory or warehouse while the legal mechanism applied to each of these case is different, specifically:

	<b>Inventory</b>	<b>Warehouse</b>
<b>Description</b>	By assets value or by type of commodity.	By assets value or by type of commodity; the address, warehouse number (if any) or other signs of the warehouse location must be included.
<b>Mortgagor's rights over the collateral</b>	To sell, replace, or exchange.	To replace but must ensure the value of commodity in stock as agreed.
<b>Changes of collateral</b>	The right to claim payment from the purchaser, the proceeds, assets formed from the proceeds, assets replaced or exchanged shall become collateral	No change.