

Priority under the Security Interests (Jersey) Law 2012: A game of snakes and ladders?

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Got your attention? If nothing else because, unless you have kids, you probably haven't played this game since your childhood. So what does snakes and ladders have to do with the law?

Whereas in that much loved board game you start off at square 0, when it comes to a lender who is taking security over the likes of shares, that lender should (with the right advice) find itself on square 100.

Suffice to say priority under the Security Interests (Jersey) Law 2012 (the **SIJL**) is complicated and differs depending on the type of Jersey situs intangible movable security that you are securing.

The source of the rules that relate to priority are set out in Part 4 of the SIJL and the general rules as to priority are as follows:

1. a perfected security interest takes priority over an unperfected security interest in the same collateral;
2. as between perfected security interests, priority is determined by the order a perfection step is taken i.e. a registration statement is filed or possession or control of collateral is achieved; and
3. as between unperfected security interests, priority is by order of attachment (or assignment, in the case of receivables).

As with all things, there are exceptions to a general rule but for the purposes of this note we shall look at the exception that might be most relevant to the reader; those special priority rules for certificated investment securities and deposit (cash) accounts.

Let's jump head long (and hopefully not down a snake) into that exception.

Deposit (cash) accounts

- **Rule 1:** A security interest which is created by way of the deposit account being transferred into the name of the secured party with the written agreement of the grantor and the account bank has priority over all other security interests in a bank account.
- **Rule 2:** A security interest attached and perfected by way of control where the secured party is the same legal entity as the account bank has priority over all security in a deposit account other than a security interest referred to in Rule 1.
- **Rule 3:** All other control security interests have priority over all other security interests other than the security interests referred to in Rules 1 and 2.

Importantly, these rules apply irrespective of the date that these security interests are created and the knowledge of any secured party. Knowledge of an earlier security interest does not affect the operation of the priority rules.

Some of you may be asking about the banker's general right of set off when it comes to a deposit account. As a general rule, that right is not adversely affected by the SIJL. Therefore, it is still necessary to seek a waiver of set-off rights from the account bank to ensure priority.

Here we go with another exception - that right of set off does **not** apply where the deposit account is transferred into the name of the secured party with the written agreement of the grantor and the account bank.

Investment securities (shares and units)

A security interest which is created by possession of the certificates of title or being registered as the holder of those shares takes priority over all other security interests.

Watch those snakes

You might think that the loss of a certificate of title would mean you would fall down the board in terms of priority when about it comes to security over shares. But think again...

If the lender has been advised well, that lender's security may be 'a continuously perfected security interest' and could continue to be secured in a super priority manner. I knew we could climb a ladder or avoid a snake somewhere...

There are other ways to ensure that the lender's security has priority.

It is open for competing secured parties having security in the same collateral to agree an order of subordination between themselves. Whilst any subordination agreement is effective without registration, a senior secured party should ensure that subordination is registered to avoid a transferee of the junior security from not being bound by the terms of that subordination.

As a matter of practice, it is the subordinated secured party who makes the registration of subordination. The senior secured party will need to ensure that sufficiently robust contractual undertakings are included within the subordination agreement so that the subordinated secured party:

- i. makes that registration of subordination; and
- ii. maintains and does not amend that registration.

Why is priority important?

It is important in the context of competing secured parties having security in the same collateral.

Determining the order of priority between those security interests decides the order in which each of the secured creditors can claim and be paid out of that collateral in an enforcement or insolvency scenario.

Where the proceeds of the security are not sufficient to pay all of the competing secured creditors in full, questions about priority are particularly critical because one or more of the secured creditors may not recover all of the amounts they are owed.

In such cases, being a higher-ranking creditor may mean the difference between recovering all amounts owed and recovering nothing at all.

Purchase money security interest

There are two types of a purchase money security interest (**PMSI**). A PMSI in favour of the seller of property and a PMSI in favour of a lender who has advanced funds to acquire the property.

Subject to the special rules applying to the likes of deposit accounts and shares (see deposit (cash) accounts, above), a PMSI has priority over another security interest in the same collateral. A PMSI is a new concept under Jersey law. Its inclusion in the SIJL seeks to ensure that financiers of collateral do not rank after general credit providers who have existing security interests.

Conclusion

In conclusion, whilst priority is a complicated issue under the SIJL, it is clear that if a lender wishes to advance debt and, as part of the security net a security interest is to be taken over a Jersey situs intangible movable asset, that lender should (with the benefit of legal advice) be able to navigate the priority waters to ensure that it has priority over any competing secured parties throughout the lifetime of the facility.

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