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Ms Anne Scrope
Department for Business Enterprise & Regulatory Reform
1 Victoria Street
London
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Dear Ms Scrope

Consultation on the draft Overseas Companies (Registration of Charges) Regulations 2009

As you are aware, the main role of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

Following the publication by the Department for Business Enterprise & Regulatory Reform ("BERR") of its public consultation on The Overseas Companies (Company Contracts and Registration of Charges) Regulations 2009 (the "Regulations") on 6 April 2009, the FMLC resolved to respond addressing issues that particularly concern its remit. To that end, the FMLC writes to address some of the inherent uncertainties in the proposals.

The thrust of the proposals set out in the revised draft Regulations is as follows. Certain charges are required to be registered by overseas companies on pain of criminal sanctions for the company and officers of the company (Regulation 6). Unregistered registrable charges are unenforceable against a liquidator, administrator or creditor of the insolvent company in the event of an insolvency proceeding affecting the overseas bank-chargor (Regulation 11). A charge is registrable if: (a) the charge is created by an overseas company which has an establishment in the UK; (b) the charged asset is "situated" in the UK; and (c) the charged assets fall within the asset classes set out in the Regulations (Regulation 4(1)). The charges requiring registration listed under Regulation 4(3) include a charge on book debts, floating charges and a charge on goodwill or intellectual property all of which may relate to financial instruments. As noted above, those charges are only registrable if the assets in question are "situated" in the UK.

The idea of intangibles being located anywhere is self-evidently a fiction. BERR has chosen to substantiate its location requirement by a *situs* test which amounts to a circular reversion to the fiction.

It is the case that, while legal rules based on the location of the encumbered asset (*lex situs*) work well in most instances for tangible assets, great difficulties arise in applying the *lex situs*

to intangible assets, at both conceptual and practical levels. From a conceptual standpoint, there is no consensus - certainly no international consensus - and no clear answer as to the *situs* of an intangible such as a financial instrument.[1] One view is that it is the place where payment must be made under the contract constituting the instrument. That place is not, however, always easy to identify, as the contract might be silent in this regard; then the law would have to specify other means permitting such identification. Another view, favoured by Dicey and Morris[2], is that the *situs* of a debt is the legal domicile or place of business or principal residence of the debtor.[3] Any of the foregoing alternatives would impose upon a prospective chargee the burden of having to make a detailed factual and legal investigation. Moreover, in many instances, it might prove impossible for the chargee to determine with certainty the exact location of a receivable since the criteria for determining that location may depend on business practices or the will of the parties to the contract constituting the financial instrument. Thus, using the *lex situs* as the indentifier for intangible assets charges over which are going to be subject to registration requirements would not provide certainty and predictability, which are key objectives for a sound registration regime in the area of secured lending.

Furthermore, even if the legislation contains detailed provisions allowing a prospective or existing secured creditor to ascertain easily and objectively the law of the location of a receivable, practical difficulties would still ensue in many commercial transactions. This is because a charge may relate not only to an existing and specifically identified intangible asset, but also to many other assets. Thus, a charge may cover a pool of present and future receivables or credit claims. In such a case, selecting the *situs* as the determinant of when an asset is within the registration requirement would undermine the practice of granting charges across whole portfolios, as different registration requirements might apply with respect to the various assigned receivables. Moreover, where future receivables are subject to a charge, it would not be possible for the foreign bank to ascertain the extent of its obligation to register the charge at the time the charge is created, since the *situs* of those future receivables is unknown at that time under almost any existing *situs* test.

The lack of certainty and clarity outlined above is a significant concern because it will have an adverse impact on overseas banks who are contemplated by the Regulations and who are in the practice of charging intangible assets for various operational reasons in the UK (e.g. charges that facilitate clearing and settling or margin lending or inter-bank lending). It is crucial for overseas banks to be able to determine adequately the location of intangibles in order for them to be able to comply with the Regulations. This will prove difficult without further clarity and the consequences of this difficulty are substantial.

The FMLC has identified two practical outcomes from the two negative regulatory consequences which arise if the registration requirements are not understood correctly. The practical outcomes are that foreign banks will either:

(i) incur significant expenditure trying to obtain clarification; or
(ii) resort to registering every charge which would be both highly inefficient and a waste of public and private resources.

These practical outcomes flow from the following negative regulatory consequences, namely that:

(i) the overseas bank may be liable to criminal sanctions; and
(ii) the charge may be unenforceable in an insolvency.

In relation to the latter consequence, whilst the FMLC does not usually comment on policy, the point has been made to the Committee that a policy of invalidating certain charges at the expense of the chargee and for the benefit of a liquidator or administrator is an odd one given

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[1] UNCITRAL Legislative Guide on Secured Transactions chap. X, A, 5(a), para 42

[2] Paragraph 22 – 026

[3] Although, according to Dicey and Morris, this rule only applies to simple contractual debts and many kinds of intangible (e.g. intermediated securities, emission allowances, intellectual property etc.) cannot be analysed in this way.

that, in the case of overseas chargors, the liquidator will be a foreign insolvency practitioner and the chargee may very well be a UK creditor.

Transparency and a complete register is highly desirable and the FMLC applauds the transparency objective but unfortunately also considers that this will be unachievable in practice. The second important area of uncertainty that this letter seeks to address is therefore how comprehensive the register would ultimately be. For instance, many charges over financial intangibles will be non-registrable by virtue of their qualifying as financial collateral arrangements under the Financial Collateral Arrangements Directive ("FCAD") (although there is some uncertainty here about the position of floating charges – see below).

In addition, there is not an established practice by overseas banks of fulfilling UK registration requirements. Foreign banks that only take foreign legal advice are unlikely even to be aware of such registration requirements. It is also important to note that overseas banks are often already subject to a registration regime in the place of their incorporation and so do not expect to be doubly burdened by a registration regime based on the location of their assets. For this reason they are less likely to comply with the registration requirements, particularly vis-a-vis foreign creditor-chargees.[4]

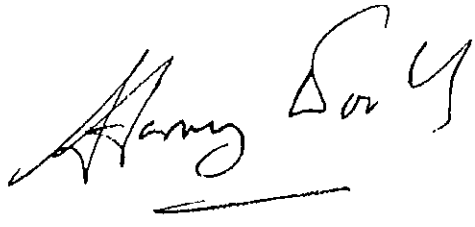
This legal lacuna and these predictable practical difficulties would almost certainly mean that such a register of charges would not be complete. A register which reveals only a proportion of charges is of very limited value to prospective creditors.

Lastly, the registration requirement largely affects floating charges and foreign charges which would be characterised as such (under the test in *Spectrum Plus*[5]), these are precisely the charges which are most in doubt when it comes to the finality provisions of FCAD. This means that uncertainty about the FCAD will be exacerbated by uncertainty about the registration requirement and about the location of assets.

Given the uncertainties set out above, the impact of such a registration requirement for intangibles may, in the case of foreign banks, be more significant than set out in the Impact Assessment. The FMLC would suggest that BERR consider, as a matter of legal certainty, whether a more detailed and precise location test for foreign corporates could be drafted perhaps with a carve-out for overseas banks. If BERR feels that this is not feasible, BERR might also consider abolishing the requirement to register charges over intangible assets.

The FMLC would welcome the opportunity to discuss this further if that would be useful.

Yours sincerely



Lord Woolf

[4] It is this consideration which means that BERR's secondary policy objective of creating a level playing field between UK and non-UK banks is unlikely to be achieved by these Regulations.

[5] *National Westminster Bank plc* v *Spectrum Plus Ltd* [2005] UKHL 41