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THE RT.HON. LORD HOFFMANN

18 October 2010

Anne Scrope
Corporate Law and Governance
Department for Business, Innovation and Skills
1 Victoria Street
London
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Dear Ms Scrope

Registration of charges created by companies and limited liability partnerships: Proposals to amend the current scheme and relating to specialist registers (the "Consultation")

Thank you for your e-mails of 6 and 9 August seeking further comments on certain aspects of the Consultation (the "Supplemental Consultation").

As you are aware, the remit of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty or misunderstanding, 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.

The FMLC notes that certain of the questions raised by the Supplemental Consultation raise issues of policy rather than legal uncertainty. The FMLC has therefore limited its response to those questions that have the potential to create legal uncertainty. The Committee has, however, had the opportunity to read the draft response of the City of London Law Society, and agrees with this response.

Registrable charges

The FMLC notes the proposal in the Supplemental Consultation that "any charge or mortgage or pledge created or lien or security granted" be registrable (subject to specified exceptions). The FMLC notes that this proposal goes further than the proposal in the original Consultation that all **charges** should be registrable, and considers that the extension of the registration requirement to pledges, liens and security (undefined) could create uncertainty as to the scope of the registration requirement. While there is substantial case law on the meaning of "charge" under English law¹, there is no established common law definition of "security". The inclusion of "security" as a registrable interest would indicate that this is intended to capture a wider range of interests than charges, mortgages, pledges and liens. In particular, there may be scope for uncertainty as to whether "quasi-security interests" such as sale and leasebacks and retention of title arrangements are required to be registered as "security". A more limited requirement to register all charges and mortgages unless excluded (whether under the

¹ See, for example, *National Provincial and Union Bank of England v Chamley* [1924] 1 KB 431, *Lovell Construction Ltd v Independent Estates plc* [1994] 1 BCLC 31, *Orion Finance Ltd v Crown Financial Management Ltd* [1996] 2 BCLC 78.

Companies Act 2006 or elsewhere) would not create this uncertainty. If the wider category of registrable security interests is adopted, the FMLC expects that this would greatly increase the number of security interests requiring registration: the FMLC questions whether the benefit of such registrations would outweigh the uncertainty that would be created.

Recharacterisation risk

The Supplemental Consultation seeks responses on whether to make provision in the legislation for charges that become registrable following a court decision (for example, to create an exemption for charges that are recharacterised as floating charges by a court decision). We understand that this arises out of a concern that, where a charge is recharacterised as a floating charge following a court decision, it may be void for lack of registration although the parties to the charge would not have been aware at the time of creation that the charge was a registrable one. The recent case of *Gray & ors v G-T-P Group Ltd*² illustrates this possibility.

The FMLC considers that an easier way to make provision for cases analogous to *Gray & ors v G-T-P Group Ltd* (where there is uncertainty about the characterisation of a charge over financial collateral) is to ensure that both fixed and floating charges over financial collateral fall within the exemption from registration for "security financial collateral arrangements" in the Financial Collateral Arrangements (No 2) Regulations 2003. If a broader exemption for security financial collateral arrangements is created (one which includes floating charges over financial collateral) pursuant either to the Consultation or to HM Treasury's consultation on financial collateral arrangements, the impact of recharacterisation would be greatly reduced. If, in addition, an exemption for overseas companies' floating charges is also created (see below), the FMLC expects that a very limited number of charges would risk being void for lack of registration following recharacterisation by court. The FMLC doubts whether the recharacterisation of charges falling outside of these two exemptions would create significant uncertainty in the financial markets and does not therefore consider that an exemption from registration for such charges is necessary.

Overseas companies

In the FMLC's original response to the Consultation, the FMLC suggested that uncertainty is created by the current requirement for overseas companies registered in the UK to register charges over property situated in the UK, due to the difficulty in ascertaining the location of intangible assets.

The Supplemental Consultation suggests that overseas companies registered in the UK should only be required to register charges over:

- UK land, whether or not registered
- Ships and aircraft registered in the relevant UK registers
- Registered intellectual property
- Tangible property in the UK both when the charge is created or when it is registered; and
- Floating charges.

If implemented, this would remove the uncertainty as to whether intangible assets are situated in the UK or not and therefore whether or not they are registrable, and the FMLC welcomes this.

However, the FMLC does consider that the requirement to register floating charges could create further uncertainty. On the face of it, the proposal would seem to require all floating charges created by overseas companies registered in the UK to be registered, regardless of the location of the underlying assets or the governing law of the charge. This would encompass many charges created by overseas companies: in particular, charges not labelled as floating charges but which are susceptible to characterisation as such by English courts may be caught. There is likely to be uncertainty as to which foreign law charges fall within the

² [2010] EWHC 1772 (Ch)

scope of the requirement. In addition, despite the registration requirement, it is likely that many overseas companies will not comply with the requirement due to failure to take English law advice, meaning that the register of charges will be incomplete. The FMLC therefore questions whether there is significant benefit to be obtained from the requirement for overseas companies registered in the UK to register their floating charges.

As you note in the Supplemental Consultation, the provisions of the Bankruptcy and Diligence etc (Scotland) Act 2007 affect the registration of charges created by overseas companies. As you know, consultation on the implementation of that Act is ongoing. The FMLC may submit comments on the interaction of that Act with the registration requirements applicable to overseas companies under the Companies Act 2006 to the Registers of Scotland: if so, we will be happy to send a copy of our comments to you.

Security financial collateral arrangements

The FMLC notes the suggestion in the Supplemental Consultation that either "security over financial collateral" or "charges over shares and their proceeds, bonds, debt instruments negotiable on the capital markets and certain other named securities insofar as not excluded by Regulation 4 of the Financial Collateral Arrangements (No 2) Regulations 2003" be excluded from registration. If the latter exclusion is chosen, this would go further than the current exclusion for "security financial collateral arrangements" and might therefore alleviate the uncertainties that the FMLC highlighted in its original response to the Consultation.

A working group of the FMLC will be considering this issue further as part of its consideration of *Gray & ors v G-T-P Group Ltd*. The FMLC also notes that HM Treasury are currently consulting on possible amendments to the Financial Collateral Arrangements (No 2) Regulations 2003, including a possible exclusion from registration for "collateral security charges". The FMLC proposes therefore to produce a response to that consultation on this issue, taking into account the impact of *Gray & ors v G-T-P Group Ltd*, and we will send a copy of that response to you.

The FMLC would be happy to discuss any of the comments made in this letter further. Please do not hesitate to contact us with any questions.

Yours sincerely

A handwritten signature in black ink, appearing to read 'H Hoffmann', written in a cursive style.

Lord Hoffmann