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25 June 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 Paper")

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 the Consultation Paper makes proposals relating to, inter alia:

(i) security over financial collateral;
(ii) registration of charges by overseas companies; and
(iii) interaction with the Scottish Register of Floating Charges.

The FMLC is considering or has previously considered issues of legal uncertainty in relation to all of the above matters, and has therefore resolved to respond to the Consultation Paper to give the FMLC's views on these issues. Although the Consultation Paper makes many other proposals, the FMLC considers that these raise primarily issues of either policy or practice, and do not raise significant issues of legal uncertainty. The FMLC has therefore only responded to questions in the Consultation Paper relevant to the three issues above.

Question 1.C – Do you consider that the requirement to register at Companies House should not apply to floating charges over financial collateral?

The FMLC is aware that views differ on whether a floating charge over financial collateral falls within the exemption from registration requirements for security financial collateral arrangements in the Financial Collateral Arrangements (No 2) Regulations 2003[1] (the "2003 Regulations") (see below).

The uncertainty exists due to the requirement in the 2003 Regulations for financial collateral to be in the "possession or control" of the collateral-taker in order to fall within the exemption for security financial collateral arrangements. Where security over financial collateral is taken by way of floating charge, it will not necessarily be the case that the chargee has possession of the collateral. It is therefore necessary to consider whether the chargee has "control" over

[1] SI 2003/3226

the collateral. In the case of floating charges, there is a spectrum of control which may be exercised over financial collateral ranging from, at one end of the spectrum, a light touch control so that the chargor may continue to deal with the assets unless the chargee specifically exercises a power to restrict dealings, to a more stringent level of control whereby all dealings over the financial collateral must be specifically authorised by the chargee. The 2003 Regulations do not provide a definition of control and therefore there is uncertainty as to the degree of control required to be established in order to fall within the exemption from registration. In addition to this, case law (*Spectrum Plus*[2]) indicates that a relatively high level of control is required in order to establish a fixed charge: consequently charges where the chargee exercises a lower degree of control will be characterised under English law as floating charges.

If the 2003 Regulations require a level of control towards the stricter end of the spectrum, then many floating charges over financial collateral would not satisfy the test and therefore fall outside the exemption from registration under the FCAR. The recent case of *Gray & Ors v GTP Group Ltd*[3] indicates that the English courts have indeed taken the view that floating charges will in certain circumstances fall outside the definition of security financial collateral arrangement in the 2003 Regulations.

The question of whether a floating charge over financial collateral is registrable is an important one in practice due to the consequences of failing to register a registrable charge: the charge is void against a liquidator, administrator or creditor of the chargor. Owing to the seriousness of the consequences of non-registration, most practitioners routinely do register floating charges over financial collateral, despite the possibility that registration is not required. Floating charges support much of the UK's secured lending. This means that many floating charges are currently registered on the basis of a cautious interpretation of the 2003 Regulations: if the law was clarified on this point, a significant number of charges would no longer need to be registered.

If and to the extent that no exemption for floating charges over financial collateral exists or is created as outlined above, there are, in any event, reasons for exempting certain categories of floating charges from the registration requirement. System-charges are charges granted in favour of settlement banks for the purpose of securing debts arising in connection with the transfers of uncertificated securities between members. These charges are typically floating charges in order that the system members can continue to deal with the charged securities in the ordinary course of business – i.e. the settlement bank (the chargee) is unlikely to have sufficient control over the collateral to fall within the current exemption for security financial collateral arrangements. These charges (and charges that play a similar role: namely market charges, money market charges and collateral security charges) are systemically important (since they support the system enabling the transfer of uncertificated securities) and it is unsatisfactory that there is lack of clarity as to whether or not such charges are registrable.

The FMLC considers that, firstly, the current legal uncertainty should be removed – i.e. it should be made clear whether floating charges are required to be registered or not. The FMLC understands that other respondents may recommend that floating charges over financial collateral be exempted from registration (i.e. by a legislative exemption which goes further than the current exemption in the 2003 Regulations): the FMLC considers that this would resolve the current legal uncertainty. If, as is proposed, s.860 Companies Act 2006 is amended to provide that all charges are registrable unless specifically excluded, it would be preferable if the existence of an exemption for security over financial collateral arrangements (whether under the 2003 Regulations or, if an additional exemption is created, elsewhere) could appear on the face of this section (for example, by wording to the effect that all charges are registrable except to the extent excluded by s.860 or by other legislation).

The power in s.255 Banking Act 2009 for HM Treasury to make regulations about financial collateral arrangements appears capable of being exercised so as to create such an exemption. The FMLC's remit is matters of legal uncertainty and therefore if such an

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[2] [2005] UKHL 41
[3] [2010] All ER (D) 80

exemption is not favoured, the FMLC would welcome the publication of guidance on the level of control required under the 2003 Regulations to constitute a security financial collateral arrangement. The FMLC notes however that any such attempt to define the level of control would inevitably be subject to further questions as to whether any given structure would satisfy the required level of control.

Finally, if no express exemption is conferred on floating charges over financial collateral in general, the FMLC regards it as essential that legal uncertainty is eliminated in relation to system charges by an express safe harbour for charges of this kind.

Question 1.D Do you consider that there should be a requirement that the crystallisation of a floating charge be registered within 21 days of that event? If so, on whom should the requirement fall and what should be the sanction?

The FMLC notes that the appointment of an administrator or administrative receiver, triggering crystallisation of a floating charge, is already required to be notified to Companies House. Third parties therefore are able to ascertain (albeit subject to some delay pending notification of the appointment) whether or not a registered floating charge would have crystallised on these events. In addition to this, the FMLC notes that the Consultation Paper proposes that the existence of an automatic crystallisation clause be a registrable particular. This would enable third parties to ascertain, by searching the register, any additional events that may trigger automatic crystallisation.

The FMLC therefore does not consider that there would be significant benefit to be gained from requiring registration of the crystallisation of a charge and considers that any benefit would be outweighed by the uncertainty that would potentially be created by such a requirement. For example, the requirement to register crystallisation has the potential to create uncertainty as to the priority order of competing floating charges. it is not clear what the impact of failure to register crystallisation would be; certainly if registration was a necessary pre-condition to crystallisation (as we understand is the case under the Scottish Register of Floating Charges for certain crystallisations), the FMLC considers that this would potentially create uncertainty as to the priority of competing floating charges which crystallise in a different order to their creation. It would also introduce an unnecessary element of delay into crystallisation. In addition, the requirement to register the crystallisation would involve the cost and burden of registration, at a time when (if the crystallisation is due to administration or other insolvency proceedings) time and money are likely to be at a premium.

Question 4.A Do you agree that overseas companies that have registered a UK establishment should continue to be required to register at least some charges that they create?
Question 4.B What charges created by overseas companies should be registrable at Companies House?
Question 4.C Should the sanction of invalidity be modified in its application to charges created by overseas companies? If so, how?
Question 4.D Should there be any other differences between the requirements for overseas companies and UK companies?

In 2009, the FMLC responded to the Department for Business Enterprise & Regulatory Reform's consultation on the draft Overseas Companies (Registration of Charges) Regulations. That response is enclosed: the FMLC continues to support the views expressed therein.

In that response, the FMLC expressed concern over the requirement for overseas companies that have registered a UK establishment to register charges over assets situated in the UK. The FMLC noted that in the case of intangible assets such as book debts, there is great difficulty in establishing where such assets are situated. Indeed, in the case of moveable assets or future receivables, it may not be possible to identify *any* location at the time of taking a charge.

Even if the location of such assets can be identified, further difficulties may arise: charges over a portfolio of mixed-location assets may need to be registered separately in many jurisdictions, undermining the widespread practice of registration of charges across entire portfolios.

For the reasons set out in the FMLC's previous response (enclosed), the FMLC considers that the current requirement for overseas companies to register charges over assets situated in the UK is unsatisfactory, and likely to lead to:

- overseas companies spending significant resources in trying to establish with clarity when the registration requirements apply;
- a Slavenburg-type problem of over-registration, leading to excess registrations at Companies House; or
- widespread failure to comply with the requirements (where overseas companies are not aware of them), meaning that the register does not fulfil its purpose of providing public notice of charges.

Even where there is compliance with the requirements, the overseas companies register is an imperfect means of recording information about a given company's charges since charges are recorded by reference to a chargor's name of incorporation, but overseas companies are not required to keep their registered name updated at Companies House. This leads to difficulties in searching the register where the company's registered number is not known.

The FMLC therefore considers that, as a minimum, overseas companies should not be required to register charges over intangible assets. The FMLC notes that if the 2003 Regulations are amended or supplemented so that floating charges over financial collateral are no longer registrable, a significant proportion of charges over intangible assets would no longer be registrable. However the conceptual difficulty of determining a location of such assets would still exist for other intangible or moveable assets, and therefore the FMLC considers that there would still be merit in removing this uncertainty. The FMLC's remit is limited to issues affecting the financial markets (and therefore largely to intangible assets); however the FMLC understands that other respondents may support the removal of the requirement for overseas companies to register *any* charges, other than those required to be registered in a UK specialist register, for example the Land Registry. The FMLC notes that this solution would also satisfactorily address the issues identified above.

Although either of these approaches would lead to a difference between the registration requirements applicable to overseas companies and those applicable to UK registered companies, the FMLC considers that there are justifications for treating overseas companies differently, as follows:

- overseas companies may be required to register charges in a register in their country of incorporation; requiring registration in the UK will lead to a multiplicity of registration requirements, making taking charges over UK assets burdensome and inefficient;
- registration of charges at Companies House is only worthwhile if the register is complete, up-to-date and easily searchable. The register is unlikely ever to be complete in respect of overseas companies, since many overseas companies will not take UK legal advice and will therefore not be aware of the registration requirements. In addition, for the reason given above, the register is not easily searchable in the case of overseas companies due to the fact that they are not required to maintain an up-to-date record of their registered name at Companies House.

Question 5.F Would it be sufficient if the information on the company's record at Companies House for a floating charge created under Scots law were:

(a) the name and registration number of the company that created the charge;

(b) the date of the creation of the charge and, in the case of a Scottish floating charge, the date of registration of any advance notice; and

(c) an indication that the charge was created by registration at the Scottish Register of Floating Charges;

or is it essential that the Companies House record show all the information proposed for charges registered at Companies House?

The FMLC is grateful to have had the opportunity to read the papers of the Technical Working Group set up by the Registers of Scotland and intends to submit comments on the Scottish Register of Floating Charges following the report of the Technical Working Group.

However at this point the FMLC would highlight that, in order for the record at Companies House to accurately show the date of registration of any advance notice, the advance notice submitted to the Registrars of Scotland would need to contain some information identifying the charge that the advance notice relates to. Without this information, the Registrars of Scotland would not be able to accurately link a charge registration to its accompanying advance notice in order to correctly date the charge. This problem is likely to be particularly acute in the case of multiple charges being granted by the same party in a short period of time.

Question 5.G Who would be most affected by arrangements so that Scottish floating charges do not have to be registered separately at both Registers of Scotland and Companies House, and how?

The FMLC intends to make submissions on this point following the report of the Technical Working Group (and will be happy to provide you with copies of any submissions). In brief however, the FMLC strongly considers that lenders who routinely take floating charges over mixed portfolios of intangible assets (that is, Scottish and English credit claims or debts) would benefit from provisions exempting them from double registration. Double registration would involve a duplication of time and cost in carrying out the registration procedure, and would create difficulties for lenders trying to create charges with the same date of creation under two different systems. These difficulties may lead to lenders ceasing to take single charges over mixed portfolios (as is common at present) and instead taking separate charges over assets in each jurisdiction. Even then, there would be a risk of Slavenburg-type registrations where the location of assets cannot be ascertained or is subject to change.

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

Lord Hoffmann

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CHAIRMAN:

THE RT.HON. THE LORD WOOLF

6 May 2009

Ms Anne Scrope
Department for Business Enterprise & Regulatory Reform
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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]

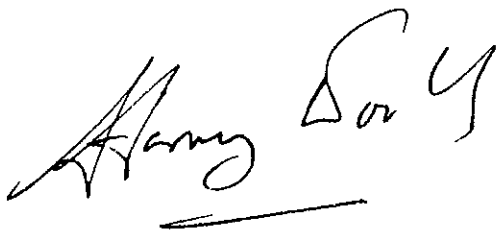
This legal lacuna and these predictable practical difficulties would almost certainly mean that such a register of charges would not be complete. A register which reveals only a proportion of charges is of very limited value to prospective creditors.

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