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Reflections on the current landscape of personal security law

KEY POINTS

- Personal security law is a legal maze, unnecessarily complex and opaque, certainly from the layman's point of view.
- Proposed reforms fall short of the creation of a uniform system of the registration of personal security interests.
- There is scope for extending the limits of common law security and consensual security in order to meet the requirements of the modern age.

The law relating to personal security in the UK is a legal maze, with seemingly difficult passages and many a *cul-de-sac*, both for lawyers and laymen, for which the legislator and, in more recent times, the regulator is primarily responsible. This article seeks to demonstrate this proposition.

THE MORTGAGES DIRECTIVE

More piecemeal regulation

It is not so long ago, on 1 April 2014, that the consumer credit regime was transferred to the control of the Financial Conduct Authority (FCA), ultimately under the Financial Services and Markets Act 2000 (FSMA), with the final implementation of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No2) Order 2013, SI 2013/1881.This Order substantially amended and extended the scope of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544 (RAO).

The implementation of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property (the Mortgages Directive), by The Mortgage Credit Directive Order 2015, SI 2015/910, on 21 March 2016, marks the further restructuring of the consumer credit regime, with consumer credit agreements secured by residential mortgage being transferred from control under the Consumer Credit Act 1974 (CCA 1974) to the FSMA regime.

In place of a consolidated enactment, which might have smoothed over the most recent transfer, we have yet another layer of legislation producing an ever more complex motley of enactments, provisions and rules, with multifarious cross references. The various changes have muddied the waters of the legislative regime that applies to consumer credit agreements. The resultant consumer credit regime is only held together by the FCA Handbook, which itself comprises a compendium of different sourcebooks, not easily navigable and only rendered feasible by electronic media and communications. Indeed, in some respects it might be said that the electronic medium is the tail that wags the textual dog.

The jigsaw composition of disjointed enactments is illustrated by the definition of a regulated consumer credit agreement in CCA 1974. The elements of the definition are the following: credit includes a cash loan and any other form of financial accommodation (s 9 (1)); a consumer credit agreement is an agreement between an individual (the debtor) and any other person (the creditor) by which the creditor provides the debtor with credit of any amount (s 8(2)). A consumer credit agreement is defined as a regulated credit agreement within the meaning of the Act if it:

- is a regulated agreement for the purposes of Ch 14A of Pt 2 of the Regulated Activities Order; and
- is not an agreement of the type described in Art 3(1)(b) of Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property. (CCA 1974, s 8(3)).

The above Directive (Art 3(1)) applies to:

- credit agreements which are secured either by a mortgage or by another comparable security commonly used in a member state on a residential immovable property or secured by a right related to residential immovable property; and
- credit agreements the purpose of which is to acquire or retain property rights in land or in an existing or projected building.

OBSCURE AND CONVOLUTED DRAFTING

The Mortgage Credit Directive Order 2015, SI 2015/910 (MCD Order), which implemented the Mortgages Directive, brings second charge residential mortgages within the scope of the RAO, where they are now included in the category of "regulated mortgage contracts" (RAO Art 61).The MCD Order also incorporates the substantial framework for regulation of consumer buy-to-let mortgages (in Pt 3 and Sch 2).

The Mortgages Directive has given rise to obscure and infelicitous nomenclature in UK legislation and the FCA Handbook. Thus we have the awkward description in the FCA Handbook of an "MCD article 3(1)(a)/3(1)(b)) credit agreement". Compounding the confusion, the Handbook coins the term "MCD Article 3(1)(b) credit intermediary" when no such credit intermediary is identified in the Mortgages Directive.

Various exempt agreements and their exceptions are also described in the RAO by cross referring directly to provisions of Art 3(1) or 3(2) of the Mortgages Directive. By way of example a "buy-to-let mortgage contract" is defined in Art 4(1) of the MCD Order by reference to provisions in the RAO and Art 3(1)(b) of the Mortgages Directive; an "exempt consumer buy-to-let mortgage contract" is defined (in RAO Art 61A (6)) by reference to Art 4 of the MCD Order and

Art 3(2) of the Mortgages Directive – and certain mortgage agreements, which would otherwise be exempt agreements under the RAO, are described by reference to Arts 3(1) or 3(2) of the Mortgages Directive. The cross referencing clearly does not assist in the creation of a uniform, comprehensible and readily intelligible framework of the law.

SEPARATE, IF NOT FRAGMENTED, JURISDICTIONS

Whilst consumer credit agreements remain subject to CCA 1974, FSMA, delegated legislation and rules in the FCA's Handbook, notably the CONC sourcebook, credit agreements secured on land (comprising regulated mortgage contracts, regulated sale and rent back agreements, home purchase plans and home reversion plans) fall within the scope of the FCA's sourcebook, MCOB. However, some credit agreements secured on land continue to be subject to CONC (1.2.7R), notably:

- an agreement under which the borrower is a relevant recipient of credit (within the meaning of Art 60L of the RAO) but is not one or more individuals or trustees; for example, a partnership comprising two or three partners, one but not all of the partners in which is a body corporate; and
- an MCD Art 3(1)(b) credit agreement secured on land, less than 40% of which is used as or in connection with a dwelling (whether by the borrower or anyone else) to the extent specified in CONC 1.2,8R. (See also CONC 1.2.8 to 1.2.11; 7.3.19; 15.1.2; and Appendix1).

Enforcement of a regulated mortgage contract continues to be subject to the requirement for a court order under the enforcement of the land mortgages provision of CCA 1974, s 126. The contract is a "credit agreement," as defined in CCA 1974, s 140C (1), and is subject to the provisions on unfair relationships between creditors and debtors in CCA 1974, ss 140A to 140C.

RESIDENTIAL RENOVATION AGREEMENTS

The MCD Order introduces the new concept of "residential renovation agreement," which is defined in CCA 1974 (s189 (1)) as a consumer credit agreement:

(i) which is unsecured; and
(ii) the purpose of which is the renovation of residential property as described in Art 2(2a) of Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers.

Article 2(2a) of the Directive referred to in (ii) above, as amended by the Mortgages Directive (Art 46), (and hence CCA 1974) applies to unsecured credit agreements the purpose of which is the renovation of residential property, whether involving a total amount of credit up to or exceeding €75,000 (equating to £60,260).

However, it appears from Art 2(2a) of the 2008 Directive that the expression "unsecured credit agreements" was intended to refer to credit agreements that are 'not secured either by a mortgage or by another comparable security commonly used in a Member State on immovable property or secured by a right related to immovable property'. But, the reference to "unsecured" in para (a) of the definition of "residential renovation agreement" above is wider and excludes any security whatsoever, "security" being defined in CCA 1974, s 189 (1).

Accordingly, it is submitted that the provisions of CCA 1974 that apply to a residential renovation agreement can be avoided simply by the agreement being made subject to any security, such as a guarantee.

PROPOSALS FOR REPLACING THE BILLS OF SALE ACTS

A welcome proposal for change, albeit of limited scope, is contained in the Law Commission's proposals for the repeal and replacement of the Bills of Sale Acts 1878 to 1890 (Consultation Paper No 225, September 2015). This envisages, among other changes, a simpler form of mortgage on goods and vehicles, online registration and searches of mortgages and registration of mortgages on vehicles at designated asset registries in place of registration at the High Court. A separate form of mortgage and registration at the High Court, electronically, is proposed for mortgages on goods. The proposed "Goods Mortgage Act" would apply to transactions where individuals, including unincorporated businesses, use goods or vehicles in which they hold title, as security for a loan or other non-monetary obligation, while retaining possession of them.

It is envisaged that registration would not be mandatory; rather failure to register a vehicle mortgage or a mortgage on goods would result in the lender's security being enforceable against the borrower but not third parties.

It is also proposed that private purchasers in good faith and without notice of a registered charge should enjoy protection equivalent to that of a private purchaser of a motor vehicle in good faith and without notice of a hire-purchase or conditional sale agreement, under Part III of the Hire Purchase Act 1964. It follows that the Law Commission's proposal would not constitute constructive notice to a private purchaser in good faith of registration of the vehicle mortgage or mortgage on goods.

The Law Commission also proposes a simpler form of registration of a general assignment of book debts in order to address, and prevent, the avoidance of book debts under s 344 of the Insolvency Act 1986 for failure to register under the Bills of Sale Act 1878. It proposes, by way of a stop-gap measure, continued registration at the High Court.

The proposals constitute no more than a half-way house to more radical reform, reform that would ensure security, transparency and efficiency of chattel mortgage registration.

MORTGAGE OF INTELLECTUAL PROPERTY

As noted above, the legislation that is envisaged to replace bills of sale is limited to security over goods and vehicles. There is no registration system for security over intellectual property rights. The mortgage of intellectual property rights, such as copyright, publication rights, a performer's property right and database rights, is effected by

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way of assignment in writing, signed by or on behalf of the mortgagor, with a proviso for reassignment on repayment of the loan (Copyright, Designs and Patents Act 1988). The mortgage may also relate to prospective ownership of copyright or database rights (ibid s 91). Where the mortgage is by deed, the mortgagee's rights are governed by the Law of Property Act 1925.

There is clearly no system or procedure for registering security interests in intellectual property rights. The shrinking global world, growth in asset value of such rights and ever- increasing threats of unlawful appropriation are likely to accelerate the need for a modern security registration system.

THE LIMIT OF COMMON LAW SECURITY

It was held in *Your Response Ltd v Datateam Business Media Ltd* [2014] EWCA Civ 281, following *OBG Ltd v Allan, Douglas v Hello! Ltd (N0 3), Mainstream Properties Ltd v Young* [2007] UKHL 21, that it was not possible to exercise a common law lien on the information held on an electronic database. The Court of Appeal was not prepared to extend the security interest arising under a common law possessory lien to intellectual property that could not be "possessed", particularly since a creditor would have had no notice of the lien. Moore-Bick LJ recognised the force in the argument for a change in the law by way of the extension of the protection of property rights in a way that would take account of recent technological developments, but the court was bound to follow the decision in *OBG v Allan*.

The court recognised that there was scope for a review of the law by parliament. It might also have invoked the view expressed by Briggs J in *Re Lehman Brothers International (Europe) (in administration) & others* [2012] EWHC 2997 (Ch) [at para [34], (although none of the counsel in that case sought to change the law), who reflected as follows:

> 'It was common ground between counsel that rights properly classified in English law as a general lien were incapable of application to anything other than tangibles and old-fashioned certificated securities. Bearing in mind the apparent desire of the draftsman of the MCA [Master Custody Agreement] to confer upon the custodian a general lien over Property (as defined) consisting mainly or almost exclusively of intangibles, I invited the parties to consider whether the time might have come for English law to take a broader view of the matter, by analogy with the approach of the House of Lords in *Re BCCI No 8* [1998] ac 214, at 228, [1997] 4 All ER 568, [1998], [1998] 1 BCLC 68 where, in relation to what had been previously been viewed by the Court of Appeal as the conceptual impossibility of a charge-back by customer to banker of an account in credit, Lord Hoffmann said this:
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> "In a case where there is no threat to the consistency of the law or objection of public policy, I think that the courts should be very slow to declare a practice of the commercial community to be conceptually impossible . . . the law is fashioned to suit the practicalities of life and legal concepts like 'proprietary interest' and 'charge' are no more than labels given to clusters of related and self-consistent rules of law.'"

THE LIMIT OF CONSENSUAL SECURITY

Consensual security in English law is restricted to a mortgage (including assignment), pledge, contractual lien and charge. Following *Re BCCI* (No 8) [1998] Ch.245, the latter would include a bank taking a charge over its own customer's credit balance.

Security interests in digital currency presents problems as a lien or pledge cannot be taken over intangibles and therefore cannot be taken over digital currency, such as Bitcoins. However, it appears feasible for a charge, in writing, to be taken over digital currency as this does not involve delivery of possession or transfer of ownership, in law or in equity. But the value in practice of such a charge is questionable, as a purchaser of the legal title (in Bitcoins, say) in good faith, for value and without notice of the charge, would acquire free of the charge. Furthermore, given the current state of technology and the absence of a register of security interests (and the inability to record the same on the public register or block chain relating to the digital currency), it appears that a charge of Bitcoins could only be achieved by the chargor also transferring to the chargee his private key to his Bitcoins wallet, for the chargee to hold with his public key, but this raises the risk of the chargee accessing the Bitcoins without authority to do so. All this is aside from the practical issues involved with digital currencies, especially in relation to client identification, anti- money-laundering requirements and the security and underlying value of the particular currency.

It is trite to observe in this connection that we are only at the beginning of a brave new world of digital currency, with many issues, not least the taking of security, remaining to be resolved, as highlighted by HM Treasury's Consultation: *Digital currencies: call for information (18 March 2015)*.

CONCLUSION

The economy depends on credit, credit depends on security and security depends on the simplicity and the ease with which the law can be comprehended, operated and enforced.

If one were to venture an opinion on the current state of personal security law, it is that we have some considerable distance to travel to reach the objective of the law meeting the demands of today's world. It is for parliament in the first instance and the courts, in the second, to endeavour to bring the law in line with those demands. ■

Further Reading:

- Taking security over Bitcoin and other virtual currency [2015] 7 JIBFL 401.
- The new MCOB "best interests" rule for residential mortgages: is it fair? [2015] 3 JIBFL 160.
- Bills of Sale Acts: ripe for reform? [2013] 11 JIBFL 685.