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GLOBAL GUIDE 2020
FINANCE

Lending and taking security in the UK (England and Wales): overview

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OVERVIEW OF THE LENDING MARKET

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

Over the past 12 months, the loan market has generally remained stable. Certain sectors of the economy and certain borrowers or issuers have been affected by uncertainty and disruption owing to a number of macroeconomic drivers, such as (amongst others):

- The UK's formal exit from the EU (Brexit).
- The unexpected breakout of the 2019 novel coronavirus disease (COVID-19) and its subsequent impact on people's health and the wider economy.
- The continuing trade war between the US and China.

The onset of the COVID-19 pandemic has led to governments and central banks around the world introducing unprecedented levels of fiscal and monetary support. Banks and non-bank lenders continue to provide liquidity with an emphasis on restructurings and refinancings. High yield issuances and leveraged financings have been somewhat limited in the face of macroeconomic headwinds.

Further, the following legal developments are noteworthy:

- Following the Financial Conduct Authority's announcement to cease compelling banks to contribute to the London Interbank Offered Rate (LIBOR) beyond the end of 2021, a working group in each relevant loan market has identified an overnight risk-free rate (RFR) for their currency to replace LIBOR. However, RFRs are fundamentally different to LIBOR, as they are based on overnight rates and therefore only permit calculation of interest at the end of an interest period. Substantial progress has been made to introduce the Sterling Overnight Index Average (or SONIA) as the preferred alternative to sterling LIBOR, while work on reference rates in other LIBOR currencies is proceeding quickly.
- The Loan Market Association (LMA) has published the "Green Loan Principles" and "Sustainability Linked Loan Principles" that are designed to facilitate the development of environmentally-friendly and sustainability-focused loan products. These principles are voluntary in nature and yet they provide valuable guidance to investors and capital providers so that capital can be re-allocated to genuine and effective causes. Companies can expect to benefit from these products in pecuniary and non-pecuniary ways, including:
  - improving their relationship with wider stakeholders;
  - enhancing their reputation as responsible businesses;
  - accessing pools of capital which are disbursed according to strict environmental, social and governance criteria; and
  - de-risking their own businesses against the harmful effects of environmental or social change.
- "Green loans" are concerned with the ends to which funds are applied. Specific green projects in need of funding will need to be identified and the loan proceeds will need to be tied to such projects by monitoring the flow of funds and using segregated project accounts. "Green projects" have an open-ended definition and include the following:
  - renewable energy;
  - energy efficiency;
  - pollution control; and
  - sustainable management of living natural resources and biodiversity conservation.
- "Sustainability linked loans" are less concerned with the use of loan proceeds and more concerned with inducing the borrower to achieve sustainability goals. For example, margin ratchets can be used to reward borrowers that achieve agreed sustainability targets.
- Under both sets of principles, transparency and accountability are predominant features and external verification or reviews are recommended.
- The Corporate Insolvency and Governance Act 2020 which passed into law in June 2020 has instituted a number of permanent and temporary reforms in respect of corporate rescues. Temporary reforms (due to expire in September 2020) include:
  - relaxing the rules on directors' personal liability for wrongful trading;
  - restricting the use of statutory demands as a means to initiate the winding-up of companies; and
  - prohibiting the presentation of winding-up petitions unless it can be shown that the relevant insolvency is not related to the COVID-19 pandemic.
- Permanent reforms include:
  - a new statutory moratorium which can be used by companies together with, or independently of, restructuring tools such as a scheme of arrangement or a new restructuring plan;
  - a new restructuring plan procedure which allows one class of creditors or members to approve a compromise or arrangement which is then binding on all other classes of creditors or members even if the latter dissent; and
  - a prohibition on relying on contractual termination clauses triggered by an insolvency.

FORMS OF SECURITY OVER ASSETS

Real estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real estate

Land, and any building, structure or other thing permanently affixed to land constitutes real property. An interest in real property can be:

- Freehold, which represents absolute ownership of the property.
- Leasehold, which represents a right to possess and use the property for a fixed period of time amounting to effective ownership of the land in question while the leasehold subsists.
- Commonhold, which applies to buildings with multiple occupiers where each occupier has a freehold interest in its unit with a commonhold association (a company limited by guarantee whose members are the individual unitholders themselves) holding a freehold interest in the structure and common parts of the building.

The Land Registry maintains a register of title to registered land in England and Wales. Any disposition of unregistered land carries with it an obligation to register the title to such land.

Common forms of security

Security over real property can be granted as follows:

- Legal mortgage. A legal mortgage over land is the strongest form of security. It does not involve a transfer of title but the secured party is granted rights which are effectively the same as that of a title holder.
- Equitable mortgage. An equitable mortgage comprises a transfer of beneficial title to the secured party by way of security for a particular liability.
- Fixed charge. A fixed charge is an equitable proprietary interest which does not involve a transfer of ownership or possession.
- Floating charge. A floating charge is a charge over real property owned by a security provider from time to time.

A legal mortgage can only be granted over property that the security provider currently owns, while an equitable mortgage, a fixed charge and a floating charge can be granted over current and future property.

Formalities

A legal mortgage must be in writing and executed as a deed. In addition, to take effect as a legal mortgage, it must by perfected by registration with the Land Registry (for registered land) or the Land Charges Department (for unregistered land).

An equitable mortgage, a fixed charge and a floating charge must be granted in writing and signed by the grantor. Customarily, this security will be granted by way of deed and executed by both parties.

A statement of particulars must be filed at Companies House in respect of mortgages and charges created by a company or LLP incorporated or registered in England and Wales within 21 days of the date on which the security was granted. Otherwise, the security will be void against other creditors, administrators and liquidators of the company or LLP.

Notice of the relevant security interest must be given to the legal owner to gain priority over subsequent security interests. This rule does not apply against an insolvency practitioner of the grantor, if there is a lack of consideration moving from the interest holder, or if the holder of the subsequent interest had notice of the former interest.

Tangible movable property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible movable property

Tangible movable property includes assets such as:

- Plant and machinery.
- Stock in trade or works in progress.
- Equipment, fittings and goods.
- Aircraft and ships.

Common forms of security

Security over tangible movable property can be granted by way of pledge, lien, fixed charge and floating charge.

Pledges and liens grant the lender a right to possession over the underlying assets. Both involve a transfer of possession but not ownership. As a result of this transfer of possession they are not often used in large financings.

Generally, a fixed charge is granted over specific chattels or a class of chattels. The beneficiary has, and exercises in practice, enough control over those assets to prevent the grantor from dealing with them free from the fixed charge. This means it is rare to take fixed security over stock and other assets a company needs to deal with freely to operate its business.

A floating charge is a form of equitable proprietary interest in the assets, or a class of assets, of the grantor from time to time. Neither title nor possession is transferred. A floating charge differs from a fixed charge in that the grantor is free to dispose of the charged assets without the consent of the secured party until the charge crystallises into a fixed charge. A floating charge crystallises into a fixed charge if the grantor ceases its business, the secured party takes enforcement action (such as the appointment of a receiver or a liquidator) or a trigger event defined in the security instrument occurs.

Formalities

As discussed above (*see Question 2, Formalities*), a mortgage or charge granted by a company or LLP incorporated in England and Wales must be registered within 21 days of its creation, or it will be void against other creditors, administrators and liquidators of the company. Moreover, where applicable, notice of the security must be given to the legal owner of the relevant assets to preserve priority over subsequent security.

There are specific title registers for ship and aircraft. Lack of registration does not invalidate the security in respect of a ship or aircraft. However, priority will be lost to a registered security interest (whether created before or after the relevant unregistered security) (other than mandatory or possessory liens). Mortgages can be registered at the British Ship Register or the Civil Aviation Authority by registering a priority notice and then registering a mortgage within the priority period after which priority will date back to the date of the priority notice.

Financial instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What

are the most common forms of security granted over those instruments? How are they created and perfected?

Financial instruments

Financial instruments include shares, bonds, notes, commercial paper, certificates of deposit, derivatives and other securities. Distinctions are made between registered and bearer forms of securities, whether securities are in the form of a global note or individually certificated, or whether securities are held through intermediaries rather than contracting parties.

Common forms of security

Security over financial instruments can be granted by way of legal or equitable mortgage (subject to the following paragraph) or assignment, statutory assignment, fixed charge and floating charge. Security in respect of financial instruments can be classified as a "financial collateral arrangement" and benefit from the financial collateral arrangements regime giving lenders enhanced rights and protection.

Legal mortgages or assignments cannot be granted in respect of intangible property since common law does not recognise such assets as property. By way of exception to this rule, it is possible to grant a legal mortgage or assignment over assets represented by negotiable instruments or over registered securities issued by a company. Transferring possession of a document of title (such as bearer bonds) or updating the register of holders to include the secured party's name are the means by which this is achieved.

Statutory assignments are established under section 136 of the Law of Property Act 1925. A statutory assignment of intangible property must satisfy the following conditions:

- It applies to existing intangible property (rather than future intangible property).
- The assignment must be absolute (the debt must be assigned in whole and the transaction must not be by way of charge).
- The assignment must be made in writing and signed by the assignor.
- Written notice of assignment must be given to the debtor.

The benefit of a statutory assignment is that the assignee can take legal action against the debtor in its own name without joining the assignor to the action.

Security over certain assets which qualify as "financial collateral arrangements" receive preferential treatment over other types of security interests. Financial collateral arrangements can only be created in respect of "cash", "credit claims" and "financial instruments" which are in the possession or control of the secured party.

The benefits of the financial collateral arrangement regime include:

- Formality requirements other than writing are removed.
- Financial collateral arrangements are made exempt from the requirement to register security with UK Companies House.
- Certain provisions of insolvency law (such as restrictions on security enforcement in an administration) are disapplied.

However, it remains unclear which assets satisfy the terms "cash", "credit claims" and "financial instruments" or what is meant by control or possession. The requirement for control or possession may mean floating charges cannot be classified as financial collateral arrangements. Out of an abundance of caution, lenders do not generally rely solely on the financial collateral arrangements regime and proceed to register their security (assignments, mortgages, charges) in the usual manner.

Formalities

As noted above, a mortgage or charge granted by a company or LLP incorporated in England and Wales must be registered within 21 days of its creation, or it will be void against other creditors, administrators and liquidators of the company. Moreover, where applicable, notice of the security must be given to the legal owner of the relevant assets to preserve priority over subsequent security.

As discussed above, transferring possession of a document of title (in the case of negotiable instruments) or updating the register of holders (in the case of registered securities issued by a company) are required to grant a legal mortgage or assignment in respect of such assets.

Legal mortgages over negotiable instruments (such as bearer debt or equity securities) can be granted by delivering possession of their documents of title.

Legal mortgages over registered shares need to be perfected by way of update to the register of members. The same principle will apply to registered debt securities issued by a company. Since the ownership structure of the grantor will be fundamentally changed upon a legal mortgage, the lenders usually opt for a statutory assignment or equitable charges. In this case, ancillary documents (such as stock transfer forms, existing directors' resignation letters, new directors' appointment letters) will be signed and remain undated and the original share certificates will be delivered to the secured party, so that the secured party can readily take legal title at a future point in time.

Claims and receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and receivables

Claims and receivables include:

- The benefit of contracts.
- Indemnities, liquidated damages or other debts.
- The right to the proceeds of insurance claims, legal actions or asset sales.
- Cash deposited in a bank account.

Common forms of security

Security over claims and receivables can be granted by way of statutory assignment, equitable assignment, fixed charge and floating charge.

The security in respect of "cash" and "credit claims" can be classified as a "financial collateral arrangement" and benefit from the financial collateral arrangements regime giving lenders enhanced protection.

Formalities

As discussed above, a mortgage or charge granted by a company or LLP incorporated in England and Wales must be registered within 21 days of its creation, or it will be void against other creditors, administrators and liquidators of the company. Moreover, where applicable, notice of the security must be given to the legal owner of the relevant assets to preserve priority over subsequent security.

Cash deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common forms of security

Security over cash deposits can be taken by way of statutory assignment, equitable assignment, fixed charge and floating charge.

It is possible that the security in respect of "cash" may be classified as a "financial collateral arrangement" and benefit from the financial collateral arrangements regime giving lenders enhanced protection.

Whether a fixed charge has been created over the receivable due from the account bank to the depositor depends on the degree of control exercised by the secured party. Where a secured party does not exercise control over the proceeds of a receivable (meaning the grantor is free to dispose of the receivable as if there were no restriction), a fixed charge will be recharacterised as a floating charge.

Formalities

As noted above, a mortgage or charge granted by a company or LLP incorporated in England and Wales must be registered within 21 days of its creation, or it will be void against other creditors, administrators and liquidators of the company. Moreover, where applicable, notice of the security must be given to the legal owner of the relevant assets to preserve priority over subsequent security.

Intellectual property

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual property

Intellectual property includes:

- Patents.
- Trade marks.
- Design rights.
- Copyrights.

Common forms of security

Security over intellectual property can be granted by way of statutory assignment, equitable assignment, fixed charge and floating charge.

Formalities

As noted above, a mortgage or charge granted by a company or LLP incorporated in England and Wales must be registered within 21 days of its creation, or it will be void against other creditors, administrators and liquidators of the company. Moreover, where applicable, notice of the security must be given to the legal owner of the relevant assets to preserve priority over subsequent security.

In the UK, there are discrete title registers for patents, trade marks and design rights. Matters of title and security registration are governed by the laws of the jurisdiction in which the relevant intellectual property has been registered. The intellectual property title registries in the UK do not require registration of security as such, however, it is advisable to do so as a registered security interest will rank before subsequently registered security or unregistered security. In contrast to title registries for UK-registered ship and aircraft, a registered security interest in respect of UK intellectual property will not rank before an unregistered security interest if there were notice of the unregistered security interest.

Problem assets

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future assets

As discussed above, it is not possible to grant legal mortgages over future property (that is, property that does not yet exist or is not yet owned by the grantor) at common law. However, a purported legal mortgage over future property may take effect as an equitable mortgage or assignment. For this to occur:

- There must be a binding contract (for which the secured party's consideration must have been executed).
- The future property must be sufficiently identified (in the sense that it must be possible to identify which assets fall within the scope of security at the time of enforcement).
- The terms of the security instrument should evidence an immediate and present intention to grant security on the grantor obtaining legal title without the need for any further action or step.

The equitable mortgage takes effect once the grantor has obtained legal title to the secured assets. Otherwise, the lender will only have a personal claim against the grantor.

Fungible assets

The nature of floating charges was discussed above (*see Question 3*). Given the operational needs of the borrower's business, a floating charge is a flexible form of security interest allowing the borrower to deal with the secured assets as if there were no security interest until the occurrence of a crystallisation event. Purported fixed charges may be recharacterised as floating charges if the secured party does not actually exercise control over dealings with the underlying asset and any proceeds arising out of it.

Other assets

Certain intangible property is incapable of being assigned or charged.

Firstly, certain rights cannot be assigned as they are contrary to public policy. Under rules against maintenance, an assignment of a bare right to litigate is void unless the assignee has a genuine commercial interest in enforcing the assigned contract or the assignment is incidental to the assignment of a right to property. A straightforward assignment of a receivable by way of security would be covered by the exception. Under the rules against champerty, an assignment of part only of the proceeds of a claim is void. Contracts considered to be personal (such as employment contracts) are incapable of assignment.

Secondly, contracts may contain express restrictions on the grant of security. Any purported assignment or charge contrary to these restrictions will be void. Whether the assignee had notice of such restriction is not relevant. The purpose of these express restrictions is to ensure that the counterparty need not deal with parties with whom it did not contract and that the counterparty's rights are not adversely affected by the assignment or charge. Assignments and charges of the proceeds of a contract, rather than the contract itself, may be upheld by courts as these do not undermine such purpose and apply between assignor and assignee only.

RELEASE OF SECURITY OVER ASSETS

9. How are common forms of security released? Are any formalities required?

Strictly speaking, charges are automatically released on satisfaction of the secured obligations while mortgages and assignments are not. However, it is common for formal release documentation to be entered into in respect of these security interests generally. Though not mandatory, a statement can be filed with the Companies House to note the complete or partial release of the relevant security for the benefit of third parties.

When the secured assets are legal or equitable interests in land, or where the original security instrument was executed by way of deed, the release documentation must be entered into by way of deed.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

It would be unusual for a lender to only take security solely over the shares of an SPV that has been set up to hold certain of the borrower's assets. It is more common for lenders to also take security directly over those assets.

QUASI-SECURITY

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

Sale and leaseback

In a sale and leaseback, the debtor sells a valuable asset to the creditor outright and then leases the asset back from the creditor. The creditor becomes the absolute owner of the asset and the debtor enjoys rights of possession and (if applicable) re-purchase only. At the end of the term, the debtor can choose to continue leasing the asset or the asset will be sold by the creditor and the debtor can participate in the sale proceeds.

As the creditor is the absolute owner it limits the possibility of unauthorised dealings with the asset and enables the creditor to dispose of the asset without appointing a receiver, a liquidator or an administrator. However, as the owner, the creditor bears the risks of loss or damage to the asset, maintenance and insurance. As a result, the creditor usually passes on these risks to the debtor in the agreement.

Further, by virtue of section 24 of the Sale of Goods Act 1979 and by way of exception to the *nemo dat* rule (the rule that a person cannot pass on a better title than the one it has), the debtor who has sold the asset but has retained possession of the asset can pass good title to a third party purchaser who acts in good faith and who is without notice of the creditor's interest.

Factoring

Factoring or discounting is an arrangement where a company sells or assigns its receivables to a creditor on discount terms and, in return, the creditor provides immediate funds which can be used by the company for its working capital. The arrangement is called "factoring" if the creditor is responsible for collecting debts and maintaining accounting records and "discounting" if the company itself will be performing these tasks.

The risks to the creditor include the company and its debtors amending the terms of the underlying receivables, the notice of assignment not being given to the debtors promptly (which has priority implications) and the presence of a negative pledge in the underlying receivables (which will render any purported assignment ineffective).

Hire purchase

A hire purchase agreement is a lease agreement under which the debtor is given possession of an asset in return for payment of an initial deposit and periodic rental payments afterwards. The rental payments represent the cost of the asset as well as a return on capital for the creditor.

Retention of title

A retention of title clause provides that the seller retains the legal and beneficial title to the asset until specified conditions have been satisfied (such as payment of the purchase price in full by the purchaser and the settlement of any other debt owing by the purchaser). The seller can terminate the arrangement and repossess the asset if the conditions are not satisfied. If the purchaser becomes insolvent without having satisfied the specified conditions, the seller will have a prior claim to the asset over the claims of the purchaser's secured and unsecured creditors as the asset was never part of the purchaser's estate.

The retention of title clause is sometimes supplemented by a proceeds of sale clause (providing that if the purchaser has re-sold the asset subject to the retention of title then a claim may be made against the proceeds of sale) and a mixed goods clause (providing that if the asset subject to the retention of title were incorporated into a larger product then the title to the larger product can be claimed). These supplemental clauses must be treated with caution since they may lead the court to re-characterise the arrangement as a fixed charge that may be void if granted by an English company or LLP but not registered at Companies House within the 21-day time limit.

Other structures

Netting is a contractual arrangement where only one of the parties owes a monetary obligation to the other party based on the net benefits received under the contract. Netting arrangements are commonly seen in derivative transactions where movements in the reference benchmark will determine which of the parties owes money to the other.

Set-off is a means of reconciling cross-claims in existence between the parties. Set-off is available as a statutory remedy and as an equitable remedy. Statutory set-off applies where there exists a cross-claim that is for a liquidated sum or is capable of being ascertained with certainty. Equitable set-off applies where the cross-claim arises out of the same transaction (although it does not need to arise out of the same contract) and it is unjust to enforce a claim without taking account of such cross-claim. On commencement of insolvency proceedings, insolvency set-off will apply in place of any contractual set-off arrangements.

GUARANTEES

12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are often obtained from other entities in the borrower's group to provide credit support in finance transactions.

Guarantees are secondary obligations, which means that if the underlying obligation subject to the guarantee is challenged or discharged, the guarantee itself may be discharged. To address this risk, guarantees are usually supported by indemnities which are primary obligations and independent of the guaranteed debt.

To be enforceable guarantees must be:

- In writing.
- Signed by the guarantor (or on its behalf).
- Either supported by consideration or executed as a deed.

RISK AREAS FOR LENDERS

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial assistance

Under the Companies Act 2006, it is unlawful for a public company to give financial assistance for the purpose of acquisition of shares in itself or in its holding company (be it public or private).

Financial assistance captures a broad range of activities such as gifts, security, guarantees and indemnities or any other assistance which causes a material reduction in the net assets of the relevant company (for example, release or waiver of pre-existing liabilities). There are statutory exceptions to the financial assistance rules.

To achieve their commercial objectives, the sponsor and related parties can convert a public company into a private company before undertaking an acquisition of shares in that company to avoid a breach.

Corporate benefit

Under section 172 of the Companies Act 2006, the directors of a company are bound to act in a manner (in their good faith judgement) which is most likely to promote the success of the company for the benefit of the company's members as a whole. This duty may be breached if the obligor company does not receive sufficient consideration in exchange for its performance obligations. Breach of this statutory duty can lead to the relevant transaction being set aside, restitution or a court order for an account of profits. In addition, on insolvency of the obligor and subject to the statutory conditions being fulfilled, the relevant transaction can be set aside as a transaction at an undervalue or a preference under the Insolvency Act 1986.

To alleviate this risk, it is customary to specify in the relevant board or similar resolution what corporate benefit any guarantor or security provider will receive in the transaction. This may be supplemented by a shareholders' or members' resolution approving the transaction.

Loans to directors

Unless the transaction has been approved by a resolution of the members of the company, and subject to exceptions, a company may not:

- Make a loan to a director of the company or its holding company.
- Give a guarantee or provide security in connection with a loan made by any person to such a director.

Any such transaction must have been approved by an ordinary resolution of the members of the company, and if the director is a director of the company's holding company, it must also have been approved by a resolution of the members of the holding company. Members must be provided with a memorandum regarding the proposed transaction to which they can refer before voting their shares. A company's articles of association may require a higher level of consent than a simple majority.

Usury

There are no usury laws in effect in the UK.

Others

Depending on the terms of financing, the particular sector or market in which the borrower operates, the legal character of the obligors and other parties to the transaction, and the peculiarities of the jurisdictions in which the obligors and the secured assets are located, it may be prudent and often necessary to engage advisors specialising in local laws, tax, accounting, regulatory, competition and environmental (among others) to identify and mitigate risks particular to the transaction concerned.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

A lender is unlikely to be liable for breaches of environmental law or the penalties arising from such breaches solely because it has provided credit facilities to the borrower. However, if the lender had knowledge of the borrower's infringement of environmental law and it had exercised control over the borrower's conduct (or if the lender itself took possession of the relevant land from which the pollution emanates or is continuing), then it may face personal liability. Environmental laws including the Environmental Protection Act 1990, the Water Resources Act 1991 and the common law claims of negligence, nuisance and *Rylands v Fletcher [1868] UKHL1* target persons who are aware of environmental pollution and who have caused such pollution in the first place or who have allowed such pollution to continue. For precautionary reasons, the lender may choose to carve out environmental law related breaches from the power of attorney it is granted in security documents and when it comes to security enforcement, it may choose not to become a mortgagee in possession.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

Contractual subordination is often used to govern priority between lenders and it is common to subordinate junior debt by agreement between the senior lender and junior lender.

These agreements can be used to subordinate junior debt both before and during the borrower's insolvency. Prior to a borrower's insolvency, the borrower will agree not to make, and the junior lender will agree not to accept, any debt payments (other than as the parties have otherwise agreed).

To maintain the agreed priority in the event of the borrower's insolvency it may be agreed that the junior lender is not permitted to prove in the insolvency until the senior lender has been paid in full. More often, however, the junior creditor agrees to "turn over" to the senior creditor any recoveries it makes from its claim until the senior creditor has been paid in full. The senior creditor is taking credit risk on the junior creditor for this obligation. To address this, the senior creditor can also require the junior creditor to hold any turnover amounts on trust for the senior creditor until the junior creditor makes the turnover payment.

Structural subordination

Structural subordination is achieved in the absence of a contractual agreement by the junior lender lending to a holding company of the senior lender's borrower. This structure subordinates the junior debt as on a subsidiary's insolvency, all the subsidiary's creditors must be paid in full before any distribution is made to the holding company.

Inter-creditor arrangements

An intercreditor agreement will be entered into if there are a number of lenders with different levels of risk exposure. The purpose of an intercreditor agreement is to determine the ranking of different claims and the order in which the proceeds of enforcement are to be distributed. The senior lenders will have the right to consider or take enforcement action in the first instance with the junior lenders subject to a standstill. The junior lenders will be required to turn over to, or to hold on trust for, the senior lenders any proceeds of enforcement which they recover in breach of the intercreditor agreement. Similarly, if a lender recovers more than their pro rata share of enforcement proceeds, they will be required to turn over the excess amount to the security trustee for the account of the other lenders. Junior lenders may lack voting power to instruct the security trustee to take a particular course of action and hence they may negotiate for a buy-out right in respect of the senior lenders' positions giving them control over the enforcement process. Consent thresholds will be important when it comes to security enforcement and in this regard, the relevant documentation should be carefully considered (for example, whether each class of lenders, as opposed to aggregation of all classes, need to give the requisite level of consent).

DEBT TRADING AND TRANSFER MECHANISMS

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

Trading of debt is common and there is an active secondary market. Debt is typically transferred by way of assignment, novation or by sub-participation.

The obligors want to ensure that their liabilities are not increased as a result of the debt transfer and that the transferee is a suitable entity (that is, not an industry competitor or a distressed debt fund) so there are often related transfer restrictions in a facility agreement.

An assignment will transfer the rights held by the existing lender but not its obligations under the contract. Therefore, existing lenders remain "on the hook" although the obligations of a lender (once it has advanced its commitment) are rather limited. In contrast, novations will transfer both rights and obligations of the existing lender. With a sub-participation, the economic interest in a loan is transferred without changing the legal relationship between the grantor (who remains the lender of record) and the borrower.

In the syndicated lending context, a security trustee will be appointed to hold the security and guarantee package on trust for the secured lenders from time to time. This means that transfers of debt during the life of the facility will not necessitate a series of releases and re-grants of security and guarantees which could have the effect of deferring the priority of existing lenders' claims against subsequent lenders and re-setting hardening periods for the underlying security.

AGENT AND TRUST CONCEPTS

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The concept of agency is recognised in England and Wales.

18. Is the trust concept recognised in your jurisdiction?

The concept of agency is recognised in England and Wales. In an English law syndicated lending context, the security trustee will usually be appointed to hold all security and guarantees on trust for the other finance parties.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Finance documents usually contain detailed provisions on when the debt becomes payable and when security can be enforced by the secured party. These provisions will determine when the right to enforce arises. Even if defaults (including non-payment defaults) have occurred under the facility agreement, additional steps may need to be taken by the lender (such as giving of a notice, expiry of a grace period or the exercise of discretion) before the debt can be accelerated or security enforced.

If not otherwise governed by express terms, the secured party can enforce rights arising by operation of law. These include an application to the court for a foreclosure order, an exercise of a power of sale and an exercise of a right to appoint a receiver of income.

Methods of enforcement

20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

The type of security interest a lender holds will determine how it can enforce its security and whether it can do so without a court order. Certain methods of enforcement are only available to the holders of specific types of security interest, although, in some cases, this can be varied by terms agreed in the security document creating the security interest.

Sale

Certain types of security interest carry an implied power of sale at common law, while section 101 of the Law of Property Act 1925 (LPA 1925) created a statutory power of sale for a mortgage or charge created by deed which can be exercised without an application to a court. The common law and statutory powers of sale are normally supplemented in the security agreement. If the security holder exercises its power of sale, the equity of redemption is barred although the proprietary interests of the debtor remain. Therefore, if the sale proceeds exceed the secured obligations, the difference is returned to the debtor.

Appointing a receiver

The holder of a fixed charge can normally appoint a receiver of the secured assets under express powers contained in a security agreement. Where this is not the case, a holder of a mortgage or charge made by way of deed can appoint a receiver of the income of the asset under the LPA 1925 where the power of sale is exercisable. Finally, a lender can apply to a court under the Senior Courts Act 1981 to appoint a receiver. The scope of the receiver's powers is usually set out in detail in the relevant security agreement and will usually include to power to take possession of and sell the secured assets, manage the business pending a sale and take other actions in respect of the assets that the owner could.

Appointing an administrator

The holder of a "qualifying floating charge" can appoint an administrator out of court by filing documents with the court. A "qualifying floating charge holder" is a person who holds a floating charge over the whole or substantially the whole of the assets and undertaking of a company. Once appointed, the principal object of the administrator is to rescue the company as a going concern (that is, to turn the company around). If this is not possible, it must aim to achieve a better result for the creditors as a whole than in a liquidation. Failing this, the administrator must realise the company's property for the company's secured or preferential creditors. An administrator is an officer of the court and must carry out its functions in the interests of the creditors as a whole.

Possession

A legal mortgagee has a right to possession which arises on the grant of a legal mortgage (though the exercise of such right is normally contractually deferred until a default). In other instances, the creditor is usually granted the express right of possession in the relevant security agreement. In practice, the right of possession is rarely exercised, mainly due to concerns about liability of mortgagees in possession. Instead, creditors will usually appoint a receiver or an administrator rather than take possession.

Foreclosure

Foreclosure is the process where the mortgagor's rights in a secured asset are extinguished (including the equity of redemption) and the assets become vested in the mortgagee. It is only available to the holder of a legal mortgage, or an equitable mortgage that is capable of being converted to a legal mortgage. For many reasons, this right is rarely exercised as a means of enforcing security, and a creditor will usually rely on exercising its power of sale.

Rescue, reorganisation and insolvency

21. Are company rescue or reorganisation procedures (outside of insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

From a liability management perspective, it is open to a company and its creditors to hold confidential discussions at any stage and seek to amend the existing documentation or enter into new ones in the face of the company's financial or operational difficulties. Apart from such private bilateral arrangements, schemes of arrangement and company voluntary arrangements (CVAs) are available. The first of these is more exposed to judicial intervention than the second.

Schemes of arrangement

A company can also make a compromise or other arrangement with its creditors, or any class of creditors, by a scheme of arrangement. The scheme must be fair, reasonable and represent a genuine compromise between the company and its members or creditors (that is, consideration must be given in exchange for compromising or diminishing existing rights). Any of the company and its creditors, members, liquidator and administrator can apply to the court to convene a meeting to consider the proposed scheme. The proposed scheme must be approved by a majority of each class of members and/or creditors and by a 3/4 majority in value. The scheme of arrangement becomes effective on the date the court order sanctioning the scheme is lodged with Companies House.

CVAs

A CVA is an agreement between a company and its creditors to restructure its debts. Although technically an insolvency procedure, it does not require the approval of a court and no moratorium is automatically imposed on enforcement of rights against the company during the CVA. Moreover, the directors will continue to run the company. The directors, an administrator or a liquidator can propose a CVA which must be approved by at least 75% by value of the company's creditors (excluding secured creditors) and a majority of the company's members. The CVA will be binding on all creditors entitled to vote. The CVA is effective as of the date of the creditors' approval and the fact of approval will be reported to the court. Secured creditors cannot vote on the CVA hence their claims against the company are unaffected by the CVA. The terms of the CVA cannot subordinate preferential creditors to unsecured creditors unless the former give their consent to such terms.

Restructuring plans

The Corporate Insolvency and Governance Act 2020 has introduced a new court-sanctioned procedure to facilitate corporate rescues and reconstructions in the UK. For this new procedure to be used, the following two conditions must be satisfied:

- The company must have encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern.
- A compromise or arrangement (that is, a "restructuring plan") is proposed between the company and its creditors or members (or any class of them), the purpose of which is to eliminate, reduce or prevent, or mitigate the effect of, any such financial difficulties.

Cross-class cram-down is a distinct feature of this new procedure. This permits a company (with court approval) to impose a restructuring plan on dissenting classes of members or creditors. A court may approve such a plan if it is satisfied that:

- No member of a dissenting class of creditors or members would be worse off under the "relevant alternative" (that is, the situation the court considers would be most likely to occur if the plan were not adopted, such as, for example, liquidation of the company as a whole or a fire sale of its assets).
- At least one class of members or creditors of the company, that would either receive a payment or have a genuine economic interest in the company if the relevant alternative occurred, voted in favour of the restructuring plan.
- Adoption of the plan would be a just and equitable outcome to the satisfaction of the court.

The courts have been vested with significant discretion as they need to determine the above questions according to their judgment. Initially at least, there will be some uncertainty as to how courts will interpret and apply the new rules to varying sets of circumstances.

The Corporate Insolvency and Governance Act 2020 requires secondary legislation to supplement its provisions, and therefore it is possible that further nuances to restructuring plans will develop. The fact that cross-class cram-downs are permitted is significant as it means that a restructuring plan can be imposed on all members and creditors even though each class of creditors and members has not voted in favour of this plan. Moreover, any pre-existing priority of payments agreed between the different classes of members or creditors can be defeated by the plan. It is also important to appreciate that a restructuring plan can be used to re-configure not only debt obligations of, but also equity interests in, the subject company.

The Act introduces a new statutory moratorium, which can be used together with or independently of the restructuring plan procedure. The new moratorium is available where a company cannot or is likely to be unable to repay its debts and, in the opinion of an insolvency practitioner (monitor), a moratorium is likely to result in the rescue of the company as a going concern. It can only be used if the company is an "eligible company" in accordance with the Act. Amongst other reasons, a company will not be eligible if, if the company is subject to a moratorium or an insolvency procedure at that time or at any time during the previous 12 months.

The new moratorium is relatively short in duration (lasting up to 20 business days, plus a one-time extension of up to 20 additional business days which the directors of the company can apply for without the consent of creditors). However, the period of moratorium can be further extended by leave of court or with the consent of creditors.

During the moratorium period, the directors remain in charge of the day-to-day business of the company (subject to supervision by an insolvency practitioner and its approval of certain transactions), while creditors and lenders of the company are prevented from taking enforcement action against the company to recover debts. However, certain liabilities incurred before the moratorium was granted must continue to be paid during the moratorium period (for example, debt service, rent and salary) and the same applies to all new liabilities which have been incurred during the moratorium period. The fact that pre-moratorium debts must continue to be paid during the moratorium period means that these debts may be accelerated and become due during the moratorium period and, if the borrower is not able to pay these debts at that point in time, the moratorium is effectively brought to a close.

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

Under the Insolvency Act 1986, creditors and other counterparties cannot assert their legal rights against the company while it is in administration without the consent of the administrator or the consent of the court. This includes enforcement of security, institution or continuation of legal proceedings or legal process, repossession of assets which are possessed by the company under hire purchase agreements, and the appointment of an administrative receiver. However, a moratorium is not equivalent to termination of the underlying rights and if an administrator wrongfully withholds consent (for example, using their consent as a bargaining chip to extract concessions) the court may order that the asset be released to the counterparty and that the administrator pay damages. A court may give leave to secured creditors to enforce their security after having conducted a balancing exercise between the interests of the secured creditor and those of the general body of creditors and consideration of whether the purpose of the administration can still be achieved. If the secured creditor was fully secured, then it is likely that significantly greater loss will be caused to the general body of creditors if the secured creditor's security is realised early during the administration. The moratorium imposed during an administration does not apply if the security arrangement is a "financial collateral arrangement". Separately, it is now possible for a company to make use of a standalone statutory moratorium independently of any statutory corporate rescue procedure. However, financing arrangements are not as impacted as noted in *Question 21*.

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

As described below, if a company goes into liquidation or administration, the insolvency practitioner can challenge and the court may set aside or avoid certain transactions which were entered into by the company in the period leading up to the insolvency proceedings under the Insolvency Act 1986.

Transactions at an undervalue

A "transaction at an undervalue" is a transaction where the:

- Creditor or secured party has provided significantly less or no consideration in return for the transfer of value from the insolvent company.
- Transaction has occurred within two years prior to commencement of the liquidation or administration.
- Company was insolvent at the time of the transaction or it has become insolvent as a result of the transaction.

A company is presumed to be insolvent if the creditor or secured party is a person connected or associated with the company. The creditor or secured party has a defence if it can be shown that the company entered into the transaction in good faith and for the purpose of carrying on its business and there were reasonable grounds at the time to believe that the transaction would benefit the company. Third party guarantees and security are particularly vulnerable to be struck down on this basis as it may be unclear what consideration was given to the insolvent guarantor or security provider.

Preferences

A "preference" is a transaction where the:

- Company has done something or has allowed something to occur with the result that the relevant creditor or secured party is put into a better position than it would otherwise be in.
- Transaction has occurred within six months prior to the company's insolvency.
- Company was insolvent at the time of the transaction or it has become insolvent as a result of the transaction.
- Company was influenced by a desire to put the relevant creditor or secured party in a better position than it would have been in if the transaction had not taken place.

If the creditor or secured party falls into a category of persons deemed to be connected with the company, then the look back period is extended from six months to two years, and it is presumed that the company was influenced by a desire to put the creditor or secured party in a better position. The last criterion of "desire" is a reference to the subjective desires of the directors of the company. If a company accedes to the provision of further security out of commercial necessity, it will be hard to establish there was a desire to improve the creditor or secured party's position. If the provision of security is a condition precedent to a loan advance and security was provided prior to the date of the loan this is not likely to amount to a preference since the creditor or secured party's position is not actually put into a better position (they only become entitled to security once they have lent the money).

Invalid floating charges

An "invalid floating charge" refers to a floating charge which has been created within a year before commencement of the insolvency proceedings in circumstances where the company was insolvent at the time of the transaction or the company became insolvent as a result of the transaction. An invalid floating charge can be saved to the extent of value received (moneys paid, goods or services provided or debts discharged and interest on the foregoing amounts) by the company at the time of the transaction or thereafter. The look back period is extended from one year to two years if the transaction was with a person connected with the company. If the floating charge constitutes a "financial collateral arrangement", then it is exempt from being voided as an invalid floating charge.

Transactions defrauding creditors

A "transaction defrauding creditors" is a transaction where the transferee has provided significantly less or no consideration for assets and the transaction was entered into by the company for the purpose of putting its assets beyond the reach of any person who may make a claim against the company or to prejudice such person's interests. The transaction could have taken place at any time and there is no precondition that the company must be in insolvency proceedings. The lender or secured party which has been defrauded can apply for a court order to set aside such transaction.

24. In what order are creditors paid on the borrower's insolvency?

In an administration or a liquidation in respect of a company, all the assets to which the insolvent company has beneficial title (that is, the insolvent estate) will be realised and the proceeds of realisation distributed to its creditors according to the Insolvency Act 1986 and the Insolvency Rules 2016 (England and Wales).

In respect of assets the beneficial title of which is held by a third party (for example, goods subject to a retention of title arrangement or assets held on trust for beneficiaries) the insolvency practitioner will transfer these assets, or the proceeds of their realisation, to the relevant beneficial owner in the first instance.

The insolvent estate of the company will be realised and the proceeds of realisation will be distributed in the following order:

- Fixed charge holders.
- Expenses of the insolvent estate (such as the costs of trading and the insolvency practitioner's fees, costs and expenses).
- Preferential creditors (such as unpaid contributions to pension schemes, unpaid wages and, in the case of an insolvent bank or building society, retail deposits whether or not protected by the Financial Services Compensation Scheme).
- Floating charge holders (subject to a prescribed part being carved out for unsecured creditors).
- Unsecured creditors.
- Shareholders.

The assets subject to a fixed charge are to be realised for the benefit of fixed charge holders only. No deductions will be made from the proceeds of such realisation other than as agreed with the fixed charge holders (for example, insolvency practitioner's fees, costs and expenses in realising the assets subject to a fixed charge).

For the purposes of the insolvency waterfall, a reference to a fixed charge means a fixed charge as at the date of creation rather than a floating charge which has later crystallised into a fixed charge. A purported floating charge which is subsequently recharacterised as a fixed charge by a court will count as a fixed charge.

The proceeds of realising assets subject to a floating charge will be applied towards the expenses of the insolvent estate, the claims of preferential creditors and the claims of unsecured creditors to the "prescribed part" first before they are applied towards the floating charge holders' claims.

As a result of the Corporate Insolvency and Governance Act 2020, for any liquidation or administration occurring within 12 weeks after the end of the new statutory moratorium, pre-moratorium debts which were required by the legislation to be paid during the moratorium period such as debt repayment and debt service (other than such debts that were accelerated during the moratorium period) and any moratorium debts, would need to be paid out of floating charge realisations ahead of the fees and costs of the insolvency practitioner, preferential creditors, prescribed part and floating charge holders.

The "prescribed part" means 50% of the first GBP10,000 of the net proceeds of realising assets subject to a floating charge and 20% of the remainder. The prescribed part is subject to a cap of GBP600,000.

Unsecured creditors will include secured creditors whose claims have not been exhausted by the proceeds of realising their security. Such creditors however cannot be paid out of the prescribed part.

CROSS-BORDER ISSUES ON LOANS

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

There are no restrictions.

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls in the UK.

BREXIT

27. If UK financial institutions no longer have "passporting" rights in the EU after Brexit, what regulatory requirements would a UK lender have to comply with to make a loan to, or purchase a loan made to, a borrower in your jurisdiction?

Brexit will not affect the rights of UK lenders to make loans to, or participate in loans to, UK borrowers.

28. Will a UK financial institution require a licence to lend after Brexit? Will a UK lender be able to take security from a borrower in your jurisdiction?

Not applicable.

TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

29. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Documentary taxes

No UK stamp taxes are payable on the grant of a loan, guarantee or security interest. UK stamp duty at 0.5% is generally payable by the transferee on a transfer of shares in a UK company. However, a transfer of UK shares to a lender (or its nominee) for no consideration as part of the enforcement of security over shares will not be subject to stamp duty.

Registration fees

Filing fees are payable in connection with the registration of security either at Companies House or the relevant asset-specific registry (in respect of land, aircraft, ship and intellectual property). These fees are nominal and immaterial.

Notaries' fees

Security documents do not require notarisation to be registered or enforced in English courts.

30. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

As taxes and fees are not burdensome, strategies to minimise the cost of taxes and fees are uncommon.

REFORM

31. Are there any proposals for reform?

Changes to protect tax in insolvency cases

The UK government announced in its budget for the financial year 2018-2019 that it would amend the insolvency legislation to move HMRC up the creditor hierarchy for the distribution of assets in the event of insolvency by making HMRC a secondary preferential creditor in respect of certain tax debts held by a business on behalf of their customers and employees, such as VAT, PAYE and employee National Insurance contributions. HMRC will remain an unsecured creditor for taxes levied directly on businesses, such as Corporation Tax and employer National Insurance contributions. The changes are expected to have effect from 1 December 2020.

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