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SECURITY-RELATED ISSUES TERMS OF REFERENCE FOR PROPOSED STUDY

Introduction

In paragraph 2.525 of its Report, the Competition Commission recommended that the main clearing groups should be required to investigate and publish a report on measures that would allow more rapid transfer of security, including, for example:

- (a) the development of a standard template for security which could facilitate assignment to a new clearing bank; and
- (b) the publication of standards and league tables on arrangements in place, and the time taken for transfer of security.

The Commission envisaged that the more rapid transfer of security would reduce barriers to switching for SMEs who have given security in respect of their borrowings from their existing bank. The Commission acknowledged that there were inherent problems in the transfer of security, including the need for the new bank to satisfy itself as to the existence, title, nature and value of security.

The scope of the proposed report – “transfer” of security

It is not clear from the Commission’s report whether it used the term “transfer” in a limited sense to denote an assignment of Bank A’s rights to security to Bank B, or whether the Commission also intended the term to include arrangements between Bank A, Bank B and the customer for the release of security given to Bank A and the grant by the customer of new security to Bank B (which does not, in legal terms, constitute a “transfer” but may, in a non-technical sense, be described as a “transfer” of security).

Given that the purpose of any study and report is to identify means by which switching from Bank A to Bank B may be expedited in cases where the customer has given security to Bank A in support of the customer’s borrowings from Bank A, it appears that it would be appropriate for the study to look at all the possible methods by which such switching may be accelerated, whether by the legal transfer of security given to Bank A, or by the more speedy release of security in favour of Bank A and the grant by the customer of new security to Bank B.

In the remainder of this paper, the term “transfer” is used to refer to all these matters.

Scope of the proposed report – steps taken by third parties

The Commission noted that it will be necessary for Bank B to satisfy itself as to various matters relating to any property which is to be the subject of security in favour of Bank B. Some of those matters (e.g. valuation, investigations of title, legal opinions regarding security) can be addressed only with the assistance of third parties (e.g. professional valuers, legal advisers). This will apply to all kinds of property, including real estate, plant and machinery, and intangible assets.

It will therefore be necessary for the report to examine the extent (if any) to which banks and their customers should seek the co-operation of third parties to adopt new procedures to accelerate the transfer of security.

Scope of the proposed report – matters not requiring to be included

The Commission made no finding that clearing banks take excessive security from SME customers (see paragraph 2.182 of the Report). Moreover, questions as to whether banks take excessive security raise quite different considerations from those to be considered in the present report.

The report should not therefore examine whether banks should rely on lesser security, or should be more willing to lend on an unsecured basis, in the future. It should be limited to addressing questions arising in the context of switching.

Proposed terms of reference

Part 1- Processes

1. The Banks shall, in each of the jurisdictions of England and Wales, Scotland and Northern Ireland, investigate and report as to how banks and other third parties presently deal with security-related matters in each of the following situations:
 - (i) An SME customer (C1) of Bank A, who has given security to Bank A in respect of his borrowings and/or any other facilities from Bank A, wishes to close his account(s) and terminate arrangements with Bank A and to establish, in their place, account(s) and banking facilities with Bank B, on terms which involve the grant of security to Bank B;
 - (ii) an SME customer (C2) of Bank A has borrowing and/or any other facilities with Bank A; C2's liabilities to Bank A are either guaranteed, in whole or in part, by a third party (D) who has given security over his assets in support of his guarantee or are secured by a third party charge over D's assets; C2 discharges his liabilities to Bank A and wishes to close his account(s) and terminate his existing arrangements with Bank A and to establish, in their place, account(s) and banking facilities with Bank B, on terms which involve either the giving by D of a guarantee, to be supported by security over D's assets or a third party charge over D's assets;
 - (iii) Bank A has issued bonds, indemnities and guarantees to third parties on behalf of an SME customer (C3) against counter-indemnities from C3 who wishes to terminate his relationship with Bank A and replicate the bonds, indemnities and guarantees facility with Bank B. The counter-indemnities may be secured by C3's assets or by guarantees and/or security from third parties.

such report to include an examination of (inter alia):

- (a) the tasks undertaken by each person involved in the process;

- (b) the timescales within which each task is undertaken;
- (c) the inter-dependencies of the various tasks;
- (d) the legal obligations and responsibilities assumed by any one such person to any other such persons;
- (e) the legal and other requirements to be fulfilled in order to complete the relevant transactions;
- (f) the legitimate interests of each person involved in these tasks and the risks to which they are exposed and against which they legitimately wish to guard;
- (g) the cost to Bank A and Bank B of the various tasks;
- (h) any additional considerations which arise where there are 2 or more banks providing facilities (instead of Bank A or Bank B alone) in particular the impact of existing Deeds of Priority or Inter-Creditor Agreements; and
- (i) the impact on timing if the customer requests different facilities from Bank B from those granted by Bank A or Bank B requires different security from that held by Bank A

and to specify which of the tasks identified in answer to (a) above might require to be undertaken more quickly, or which other elements of the overall process might require to be altered to allow the overall process to be completed more quickly.

The Banks shall, so far as practicable, identify in their report all the legislative instruments and principles of common law which are relevant to these matters. The Banks shall also, so far as practicable, identify the extent to which (in respect of Scotland and Northern Ireland) such matters are reserved matters, where that might affect the enactment of any amendments to the existing law.

In preparing the report, the Banks shall consult with such third parties as they consider necessary or appropriate (including, to the extent they judge appropriate, the Law Society, the Land Registry, the Land Charges Registry, the RICS, local authorities, Companies House, Life Insurance companies, the equivalent bodies in Scotland and Northern Ireland and, in Northern Ireland, the Department of the Environment (NI) and the Northern Ireland Housing Executive).

Part 2 – Suggestions for Change

2. The Banks shall, in each of the jurisdictions of England and Wales, Scotland and Northern Ireland, investigate and report as to:
 - (A) how the tasks and processes identified in the Part 1 of the report could be changed, or what new arrangements could be adopted:

- (i) so as to facilitate the faster attainment of the objectives contemplated in 1 above (i.e. the switching by customer C1, C2 or C3 of his account(s), and associated borrowing or contingent facility arrangements, from Bank A to Bank B);
- (ii) whilst effectively protecting the legitimate interests of each of the persons involved in the attainment of those objectives; and
- (iii) recognising the additional considerations when more than one Bank replaces Bank A;

having regard to (inter alia) the following possibilities:

- (a) the adoption by banks of common forms of lending and security documents;
- (b) the provision by valuers and legal advisers of opinions addressed to Bank A for the benefit of both Bank A in respect of its facilities to customer C1/C2/C3 and of subsequent providers of such facilities to customer C1/C2/C3;
- (c) means by which credit facilities and/or security may be transferred by Bank A to Bank B; and
- (d) legislative changes which might facilitate the attainment of the objectives identified in 1 above.

(B) The possibilities for new arrangements having regard to:

- (i) the likely effects of forthcoming changes in the law that are currently being proposed, and the possible effects of any legislative changes proposed or put forward for consideration in any Law Commission Reports or Government White Papers (including any such reports or papers relating to the law in any one or more of the jurisdictions under consideration).
- (ii) the extent to which existing SME customers of banks would benefit from the changes and new arrangements identified in (A) above (and whether it would be appropriate to adopt transitional arrangements in respect of existing SME customers of banks);
- (iii) the advantages and disadvantages to banks and SMEs of the use by banks of common security and/or lending documents;
- (iv) the effect of any changes on banks' willingness to lend to relevant SMEs;
- (v) the different legal issues arising in respect of different SMEs according to whether they are, for example, sole traders, partnerships, limited partnerships, limited liability partnerships, companies limited by shares or guarantee, other bodies corporate, unincorporated associations, trusts, clubs and charities;

- (vi) the impact of Land Registry and other registration fees, the possible re-introduction of stamp duty on the transfer of security, and the effects of all other costs borne by SMEs in connection with the transfer of security;
 - (vii) the need to negotiate and implement revised priority arrangements with third party holders of security (typically second or subsequent charge-holders);
 - (viii) the different or additional issues which arise where 2 or more banks provide facilities (instead of Bank A or Bank B alone);
 - (ix) the effect of any changes on each Bank's contingent liabilities;
 - (x) the effect of any changes on each Bank's capital requirements, currently and in the light of the implementation of Basle 2;
 - (xi) the present requirement for independent legal advice in connection with guarantees and third party security;
 - (xii) any necessity for compulsory first registration at H M Land Registry or the Land Registry of Northern Ireland;
 - (xiii) any contractual restriction on the transfer of security or restrictive covenants in the title to property.
- (C) Who would need to participate in any changes or new arrangements identified in (A) above in order for them to be effective and how such persons might be required or induced to participate in such changes or new arrangements.
- (D) What would be the benefits and what would be the costs or detriments to any persons arising from the implementation of the changes or the adoption of the new arrangements identified in (A) and/or (B) above, including an estimate of the extent of any gain in the speed of switching which could be expected to be achieved by virtue of the changes and new arrangements identified in (A) and/or (B) above.
- (E) The advantages and disadvantages which might be expected to ensue from any scheme for the publication of standards attained by specific banks, and league tables of such standards, containing details of the time taken for the completion of specific steps to facilitate the transfer (or release) of security having regard to:
- (i) the cost of providing such information;
 - (ii) its effect on SMEs' choice of bank; and
 - (iii) any incentives which it could be expected to create for banks to attain higher standards in respect of such matters

and, if so, what information could be published, by whom, and in what manner.

The Banks shall complete the report by 14 March 2003.

In preparing the report, the Banks shall consult with such third parties as they consider necessary or appropriate (including, to the extent they judge appropriate, the Law Society, the Land Registry, the Land Charges Registry, the RICS, local authorities, Companies House, Life Insurance companies, the equivalent bodies in Scotland and Northern Ireland and, in Northern Ireland, the Department of the Environment (NI) and the Northern Ireland Housing Executive).

Definitions

3. In these terms of reference, the following definitions shall apply.

“Banks” means:

AIB Group (UK) plc, in respect of First Trust Bank’s SME business and branches in Northern Ireland.

Bank of Ireland, in respect of its SME business and branches in Northern Ireland.

Barclays Bank PLC, in respect of its SME business and branches in England and Wales.

Clydesdale Bank (a subsidiary of National Australia Bank Limited), in respect of its SME business and branches in Scotland.

HBOS plc, in respect of Bank of Scotland’s SME business and branches in Scotland.

HSBC Bank plc, in respect of its SME business and branches in England and Wales.

Lloyds TSB Bank plc, in respect of its SME business and branches in England and Wales,

Northern Bank Limited (a subsidiary of National Australia Bank Limited), in respect of its SME business and branches in Northern Ireland.

The Royal Bank of Scotland Group, including The Royal Bank of Scotland plc in respect of its SME business and branches in Scotland, National Westminster Bank plc in respect of its SME business and branches in England and Wales and Ulster Bank Ltd in respect of its SME business and branches in Northern Ireland.

For the purposes of these terms of reference, “security” shall mean each of the following kinds of security and guarantees (and such other security as the Banks may find it appropriate to consider):

- (i) guarantees;
- (ii) counter-indemnities;
- (iii) security given in any of the following forms:

- (a) security over estates in land;
 - (b) security over shares;
 - (c) security of life policies;
 - (d) a debenture creating (inter alia) a fixed charge over book debts and/or a floating charge over substantially all the assets and undertaking of the borrower (or in Scotland, a statutory floating charge);
 - (e) an agricultural charge;
 - (f) security over cash.
- (iv) Irrevocable Mandates/Assignations of Sale or Loan proceeds (Scotland only);
 - (v) Lodgement Letters (Scotland only);
 - (vi) Ship Mortgages.

Project Management

A Working Group (WG) consisting of at least one representative from each of the participating Banks will manage the project to produce this report.

The WG will appoint a chairman.

The nominated representatives on the WG will draw upon internal resource from within their respective Banks as necessary to further the project and provide all required information.

The nominated representatives on the WG will obtain all executive authorities from within their respective Banks in order to further the project.

It is envisaged that an external consultant will be employed to produce the report. The Banks will be responsible for selecting the consultant and agreeing the consultant's terms of engagement.

The consultant will be bound by the Terms of Reference but will be accountable solely to the WG. The WG will monitor the progress of the consultant's work.

The Banks will, as appropriate, provide updates to the OFT on the progress of the project and provide copies of working papers where the Banks decide this would assist the OFT to understand some of the technical issues addressed by the study.

Guidance notes for use by the WG are attached to this TOR by way of appendix and are for information only.

The WG will consider whether the efficient preparation of the reports envisaged by these TOR requires the establishment of a separate steering group. If so, then the Banks will establish a separate steering group, to oversee the work of the WG.

Appendix - Guidance notes for Project Management Working Group.

Information.

Information will be required from the Banks and other parties of present procedures for taking security.

Information will be required as to how such procedures could be changed (e.g. through use of new technology, new terms of dealing etc.) and to what extent such changes are already planned.

Banks will require legal advice as to the legal implications of changing present procedures, under the present law, and of legislative changes which would address any issues identified.

It is envisaged that separate sub-committees of the working party would oversee the reports insofar as they relate to different issues arising in the different jurisdictions affected (England and Wales, Scotland and Northern Ireland).

The Banks would instruct the consultant to issue questionnaires to some third parties.

The Banks may wish to instruct the consultant to gather information from third parties in two stages, to deal with the separate issues raised by Part 1 and Part 2 of the report.

Analysis.

The consultant will circulate information (other than bank-specific confidential information) to the working party (see below) for discussion and analysis.

The Banks will instruct the consultant to record their discussions and conclusions in a draft report, for review by the Banks.

Third parties & Consumers.

Third parties will be consulted at all appropriate stages.

Part 2 of the report will contain a cost benefit analysis in which the costs and benefits to third parties will be evaluated.

At this stage, it is envisaged that consultation should include the Law Society, the Land Registry, the Land Charges Registry, the RICS, local authorities, Companies House, Life Insurance Companies, the equivalent bodies in Scotland and Northern Ireland and, in Northern Ireland, the Department of the Environment (NI) and the Northern Ireland Housing Executive. Other interested third parties may be identified as the matter progresses.

Final Report.

The OFT will be shown copies of final drafts of the report prior to publication.

The final report (with any confidential material excised) will be published by the Banks on the BBA web-site by 14 March 2003..

To the extent that any Bank or Banks disagree with any views or conclusions set out in the Report, the Report will record that such disagreement exists and will set out the reasons for such disagreement.