Minister for Public Finance, Planning and Community Wealth
Tom Arthur MSP

Scottish Government
Riaghaltas na h-Alba
gov.scot

Stuart McMillan MSP
Convener
Delegated Powers and Law Reform Committee

DPLR.Committee@parliament.scot

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I am grateful to the members of the Delegated Powers and Law Reform Committee for its most comprehensive Stage 1 Report on the Moveable Transactions (Scotland) Bill. This letter comprises the Scottish Government's response to the recommendations and comments made by the Committee in its Report.

Consultation on the Bill

As noted in paragraph 273 of the Policy Memorandum, the Government's Programme for Government published in September 2019 indicated that officials would conduct a focussed consultation on the SLC proposals for legislation in this area. I would therefore like to clarify that concerns from consumer organisations were identified back in January 2020 well ahead of Parliamentary scrutiny. However, following the delay to the Bill caused by the pandemic, when officials recommenced correspondence with Citizens Advice Scotland (CAS) their position had shifted and they commented that "*The current development of the consumer duty applicable to creditors by the Financial Conduct Authority should ameliorate many of our concerns at the product design stage. We will address any consumer harms engendered by reference to appropriate legislative and regulatory channels as occasion demands*.". However, I appreciate that this position has been revised.

As such, I met CAS, Money Advice Scotland, Step Change Scotland and Christians against Poverty in October 2022 to discuss their continuing concerns which have been considered carefully, as indicated below.

In addition, the Scottish Government wrote to Money Advice Scotland in 2020 and to Step Change Scotland in 2021 seeking comments on the proposals on moveable transactions, but no responses were received to those approaches.

In view of the overwhelming support for the reforms proposed in the SLC recommendations, identified by the SLC in its consultations and by the Economy, Energy and Fair Work Committee in the last Parliament when it issued a call for views in November 2019, it was not believed that this Bill would generate substantial controversy and it therefore appeared to be an ideal candidate to be designated as an SLC Bill.

In relation to the Committee's suggestion that further consultation should be undertaken where the Scottish Government is considering introducing a Bill to give effect to an SLC Report, and significant time has passed since the SLC's original consultation on its proposals, I have passed this suggestion on to the Minister for Community Safety whose Ministerial remit includes liaison with the SLC.

General impact of the reforms

I welcome the Committee's conclusion that the reforms will have a beneficial impact on business and access to credit. I also agree with the Committee that the practical difficulties involved with the current operation of the floating charge make it a less attractive option.

Assignation

Financial collateral arrangements

As the Committee is aware, the draft Bill was amended prior to introduction because the Scottish Government considers that several of the provisions of the SLC's Bill, concerning financial instruments and financial collateral (arising by way of the operation of the Financial Collateral Arrangements (No. 2) Regulations 2003), are outwith the legislative competence of the Scottish Parliament. The Scottish Government position is based on legal advice received by it and the Committee will be aware that the Scottish Ministerial Code precludes the sharing of legal advice. Therefore, I am unable to provide any further detail on this point.

My officials have again been in touch with the Scotland Office about their consideration of the Scottish Government's request for a section 104 Order and discussions are continuing about what information the Scotland Office and the Office of the Advocate General require in order to make their assessment of the need for an Order. I will of course inform the Committee of any developments in this matter and can reassure the Committee it is being treated as a priority.

Assignation of debt by consumers

The requirement for intimation of the assignation of a claim to a debtor was introduced in Scotland by the Transmission of Moveable Property (Scotland) Act 1862.

For that reason, the requirements of the 1862 legislation are habitually bypassed by financial institutions who wish to assign, i.e. sell, consumer debt since it would be cumbersome and very expensive to intimate to hundreds or possibly thousands of debtors. Legal workarounds are routinely employed whereby the claims are assigned under English law which does not require intimation to debtors. In reality the removal of intimation has already happened in practice. It is worth pointing out that the law in the comparator jurisdictions of France, Germany, Australia, New Zealand, Canada and the United States also does not require intimation of assignation of a claim to a debtor.

The Financial Conduct Authority still requires intimation for regulated credit agreements under its handbook "CONC" paragraph 6.5.2:

"(1) Where rights of a *lender* under a *regulated credit agreement* are assigned to a *firm*, that *firm* must arrange for notice of the assignment to be given to the *customer*:

(a) as soon as reasonably possible; or

(b) if, after the assignment, the arrangements for servicing the *credit* under the agreement do not change as far as the *customer* is concerned, on or before the first occasion they do.".

It is understood that, in practice in Scotland, payment of debt continues to the original creditor, even if the debt has been assigned, and the original creditor passes on the payment to the new creditor unbeknown to the debtor.

Debtors are therefore generally not receiving intimation of assignation of their debt at present unless this happens under the FCA regulations (in which case, it will continue under those regulations anyway).

I am pleased that the Committee recognises the advantages of the dual system for assignation proposed in the Bill. What will happen in the future will be that assignors and assignees will have a choice of intimation or registration in the new Register of Assignations.

The retention of intimation of assignation **in all cases** (which would likely be ineffective given that the 1862 legislation is routinely bypassed by the use of English law) would, however, be a backward step for Scots law. It would negate the benefits of Part 1 of the Bill (the introduction of the Register of Assignations) and particularly what would otherwise be the vastly enhanced ability of business to acquire funding by transferring (i.e. selling) to a financial institution its claims to payment of its current and/or future customer invoices. One cannot intimate to a future debtor since it is not known who they are.

Assignation of debt by intimation to a debtor is likely to only happen in cases where the parties are concerned about confidentiality and do not wish to register an assignation in a public register. It is expected that it will be much more common to register assignations in the new register.

In practice, in circumstances where a debtor may be in difficulty and wishes to negotiate with their creditor, it will be much easier in future to establish who that creditor is by searching the Register of Assignations to establish (a) whether a claim has been assigned (if there is no entry in the register then it has not, unless the debtor has received intimation of assignation) and (b) who the new creditor is (this will be the party to whom the claim has been assigned). In contrast, it is difficult to find out who owns the debt under the workarounds that are used at present.

Consumers will therefore be in a more advantageous position in relation to establishing whether their debt has been transferred to another financial institution, without the need for intimation for all assignation of debt which would take this aspect of law back to Victorian times.

We have been told by practitioners that assignation of consumer debt will make up early and heavy usage of the new Register of Assignations since financial institutions will wish to take advantage of the new, easy and cheap method of registering assignation in Scotland which will not involve expensive legal workarounds. Research into anticipated usage by the Registers of Scotland (RoS) among likely users of the new register confirms this assessment.

The Scottish Government will, however, undertake further research into the likely use of the Register of Assignations for assignation of consumer credit debts by financial institutions and the impact on consumer credit debts and will report back to the Committee ahead of the deadline for Stage 2 amendments.

Waiver of defence clauses

As I explained when I gave evidence to the Committee, the Bill changes nothing in relation to waiver of defence clauses: it simply puts a common law rule into statute. I also indicated that if there were concerns about the drafting of section 13, these can be addressed at Stage 2.

The Government welcomes the Committee's acceptance that the option to waive defence clauses is a commercial consideration as the waiving of defence clauses may make a claim more attractive to a potential assignee, but we will, as invited by the Committee, reflect on the position of sole traders and whether the option might be removed for sole traders.

The Government will take soundings on the need to amend the Bill at Stage 2 to remove the option of waiving defence clauses for individuals not acting in a business context, but tends to believe that the correct place for regulation of assignations of consumer credit agreements is consumer credit law and, more generally, the place for protecting consumers from unfair contract terms is the Consumer Rights Act 2015.

Application of statutory pledge to individuals

The Committee has recommended that the provisions of Part 2 of the Bill should be amended at Stage 2 to remove its application to individuals as opposed to businesses. In other words, it would not be possible for individuals, as opposed to businesses, or to grant a statutory pledge. Failing that, the Committee has recommended that the consumer protections in the Bill should be strengthened.

Citizens Advice Scotland and various money advice agencies advocated amending the Bill to remove its application to individual consumers whom they felt would be at risk of being sold products based on statutory pledge using household goods as collateral and at exorbitant rates of interests by predatory lenders. While no evidence was produced to confirm that this would happen, I understand that it is the firm view of the sector based on their practical experience.

The main benefits of the reform of the law relating to moveable transactions in Scotland will be felt by businesses since it should make it much easier for those businesses to raise finance to invest in their future development.

While the proposals were intended to be available to individuals as well, we do not believe that the provisions of the Bill would be utilised by individuals to any great extent. It was never the intention of the SLC or the Scottish Government, as a matter of policy, that individuals would have been able to pledge ordinary household goods as collateral for a loan under a statutory pledge. It is also very unlikely that financial institutions would lend money using ordinary household goods as collateral since such items are likely to depreciate in value very quickly to the point where their value may not cover the amount of the loan.

If individuals were unable to use ordinary household goods as collateral for statutory pledge, the other kind of moveable property owned by most people which might be used in relation

to statutory pledge, mainly for acquisition purposes, would be motor vehicles. We understand, however, from UK Finance (which incorporates the Asset Based Finance Association) that its members are unlikely to move from using hire purchase to statutory pledge as the legislative means to finance car acquisition. This is because (a) the hire purchase legislation has been in force for nearly 60 years; and (b) their systems are all set up for hire purchase.

The SLC suggested that individuals would be able to use art works or expensive musical instruments as collateral for statutory pledge. We believe that the number of individuals who might be able to use such moveable property is likely to be comparatively small and those who own such items are likely to have other means of raising finance without using them as collateral.

Comparator jurisdictions extend their moveable transactions law to individuals as well as to businesses. If, however, as a matter of practicality, the reformed law of moveable transactions is not likely to be of much benefit or used very much by individuals in Scotland, then the international position seems of little relevance. Consideration could of course be given to extending the law to individuals at some point in the future with strengthened consumer protections if a convincing argument was made in support of such an extension.

The difficulty in removing the application of the Bill from individuals is that, as some stakeholders have previously pointed out, and as the Committee is aware, it may sometimes be difficult to establish whether a statutory pledge has been granted by an individual or a business. The Federation of Small Businesses (FSB) has highlighted that sole traders and other smaller, unincorporated businesses should be able to access finance using the provisions of the Bill even if its application to individuals is removed. Careful consideration will be given to Stage 2 amendments to protect the position of sole traders and start-up businesses, but enable them to take advantage of the reforms in the Bill.

Given the likely very low usage of the provisions of the Bill by individuals (except sole traders), and in view of the concerns which have been expressed by money advice organisations about the potential for abuse of the Bill's provisions on statutory pledge, the Scottish Government accepts that the Bill should be amended at Stage 2 to remove the ability of individuals other than sole traders to grant a statutory pledge. Care will, however, have to be taken in amending the Bill to remove its application to individual consumers, while ensuring that sole traders and other unincorporated businesses can still benefit from its provisions. We would be happy to work with the FSB and others on this.

Review of the operation of the Bill

The Scottish Government will consider whether it is necessary, in the light of the proposed removal of the ability of individual consumers to grant statutory pledge (which was the area of greatest concern), to amend the Bill to require a review of the operation of the Bill after a 3 to 5 year period. However, it is of course open to the Government to review legislation at any time, and indeed for the Parliament to carry out such post-legislative scrutiny as it considers appropriate. Undertaking such reviews as and when the need for them becomes apparent is a more flexible and responsive approach than committing to a review at a point where the appropriate timescales for such a review may not be known. For example, if this legislation had been in force earlier and had included such a review provision, the disruption to business caused by the coronavirus pandemic would likely have rendered any review premature because many relevant business activities would have been quite different from normal for a substantial amount of the period under review, but it would nonetheless have been necessary for the review to proceed.

The Scottish Government will of course keep the law in this area under review as appropriate, including how regulation-making powers can be exercised in order to address any practical issues that arise with the operation of the law. As noted in the Delegated Powers Memorandum published with the Bill at introduction, powers have been taken where appropriate in an effort to ensure changes can be made where necessary.

Consumer protections

Given that it is proposed to amend the Bill to remove the ability of individuals other than sole traders to grant a statutory pledge, the need to strengthen the consumer protections in the Bill largely falls away, but the Scottish Government will consider carefully whether any protections are required for sole traders and, if so, what those should be.

Enforcement against individuals

The Committee's recommendation that the Bill be amended to create additional criteria which must be satisfied before a statutory pledge can be enforced against an individual not acting in a business context will also fall away in view of the proposal to remove the ability of individuals to grant a statutory pledge.

Enforcement against small businesses without a court order

The Scottish Government will happily consult with representatives from small businesses and financial institutions as to whether the Bill could be amended to increase protections for small businesses in relation to the enforcement of a pledge. This matter could also be the subject of any post-legislative scrutiny in the light of the operation of the enacted Bill.

Links with Companies House

The Scottish Government has already raised, with counterparts in the UK Government, the prospect of an Order being granted under section 893 of the Companies Act 2006 to enable reciprocal registration between the new registers in Scotland the Companies Register.

Voluntary updates to the Register of Statutory Pledges

The understanding of the Scottish Government is that, in comparator jurisdictions with modern moveable transactions law, assignations, restrictions and discharges of the equivalent of statutory pledges take place off-register as a matter of commercial expediency with no compulsory registration within set time periods and this was the recommendation of the SLC. It will, however, be possible for assignations, restrictions and discharges and other changes to be registered on a voluntary basis (as an application for a correction) and it is expected that the online and very straightforward system of registration – and low registration fees set by Ministers after consultation – will encourage the registration of these events.

This approach is supported by UK Finance (who represent approximately 75 bank and non-bank finance providers providing a range of lending products to businesses, including invoice finance, asset based lending, and term lending) who have indicated:

> "Ultimately it would be in the interests of both a party seeking finance and the prospective provider of finance to ensure that the registers present an accurate picture of current available security and we submit that these commercial incentives will be more effective in this respect than unnecessary additional bureaucracy".

In other words, UK Finance do not favour compulsory registration of assignations, restrictions and discharges, but think that commercial pressures will normally lead parties to register these amendments to the register which will thus make the register more accurate. It will therefore be necessary to make enquiries of the registered statutory creditor as to whether they remain the statutory creditor and whether the registered pledge still affects the same property, because registration of events which might change the position in relation to these facts will be voluntary and the register will not therefore be comprehensive.

However, this will be counter-balanced by the fact that both a new secured creditor to whom a pledge has been assigned and a provider of a pledge which has been restricted or discharged will be able, if desired, to ensure the register is updated to reflect that fact. There is also a requirement for the register to be updated where a pledge has been enforced.

Timeous updates

The Committee suggests that the Bill is amended to require certain updates to be made timeously or within a specific period (and mention is made of creditors in England being slow to update discharged securities). It should be noted that where a person with an interest in the pledge (for example, the provider) wishes the register to be updated, they are already able, under section 96(4)(b) of the Bill, to set a time limit for the secured creditor to act. If the secured creditor does not then act in that period, the interested person then becomes entitled to make the application themselves.

However, in circumstances where a person with a specified interest is not seeking the correction, it would not be appropriate to introduce timeframes because there is no underlying expectation that the change should be made.

Time limits

A searcher of the register who discovers that such a time limit has been set will not, however, be able to rely on the statutory pledge having expired (since the pledge may have been discharged off-register or the period for repayment may have been extended beyond the expiry date). They will therefore have to make enquires of the party who is identified on the register as the secured creditor.

Processes for correction

The Scottish Government believes that the processes for corrections which RoS are already putting in place in the prototype registers will be user-friendly, since these will be online and automatic, in common with initial applications for registration. Applicants, who will normally be the provider of the statutory pledge (i.e. the debtor) will simply fill in fields on a page onscreen. The Committee may wish to seek a further demonstration of the prototype registers in this regard. It is therefore considered that the correction processes in contemplation represent a straightforward accessible mechanism.

Regulations

The Scottish Government will share draft regulations providing the rules of procedure for the two new registers as soon as these are available. The regulations will of course be guided by the final shape of the Bill that Parliament agrees. Work has already begun on the regulations in tandem with the development of the prototype registers by RoS, in

collaboration with stakeholders. To finalise the preparation of the rules in advance of that IT work would be premature.

Fees

The fees which will apply for registration events and searches in the two new registers will be the subject of consultation and it is therefore not possible to give more specific information at this stage about what the fees are likely to be. The SLC Business and Regulatory Impact Assessment indicated that registration fees were likely to be of the order of £60 and search fees may be up to £4. Given the value of the assets affected by a statutory pledge may be of the order of hundreds of thousands or even millions of pounds, and compared to other fees (for instance the current registration fee for a standard security in the Land Register is £80), our view is that these fees are reasonable.

Pursuant to section 110 of the Land Registration (Scotland) Act 2012, the fees which may be set out by order by the Scottish Ministers are to be determined after consulting the Keeper about the expenses incurred by the Keeper which the fees cover. Further consideration can be given when consultation takes place on fees for the two new registers as to whether certain categories of searchers should be able to make searches free of charge, though as noted above, it is anticipated that the likely fees for searches will be very low. This matter would have to be discussed with the Keeper of the Registers, particularly with regard to the practical impact on all users of the new registers.

Financial instruments

As noted above in relation to financial collateral arrangements, my officials have been in touch with the Scotland Office about their consideration of the Scottish Government's request for a section 104 Order and discussions are continuing about what information the Scotland Office and the Office of the Advocate General require in order to make their assessment of the need for an Order.

I can assure the Committee that the Scottish Government will pursue such an Order as a priority since, as it has been pointed out to the Scotland Office, it will be impossible to extend the provisions of the Act to the areas considered reserved if a section 104 Order is not granted. The Bill would still be capable of operating, but the inability to include these issues would be detrimental to businesses here in Scotland and would not of course implement the SLC recommendations in their entirety. It would, for example, be impossible to use the provisions as drafted in the Bill to facilitate the use of Scottish shares as collateral for a loan using the proposed new statutory pledge.

Electronic signatures

In my letter to the Committee of 14 November, I noted that there was no strict requirement for electronic signatures under the Bill. Section 1(1) requires the assignation document to be "*executed"* (wet signature) or "*authenticated*" (electronic signature) by the assignor. Section 43(2) requires the constitutive document for a pledge also to be either "*executed"* or "*authenticated*" by the provider. The definitions of "*executed*" and "*authenticated*" are provided in section 116(1) of the Bill and derive from corresponding definitions provided in the Requirements of Writing (Scotland) Act 1995. The Scottish Ministers have the power under section 116(3) to modify the aforementioned definitions should it be deemed necessary or appropriate.

The definition of “authenticated” in the Bill, taken in combination with the authentication requirements for registration in the Keeper’s registers contained in section 9G of the 1995 Act, means that only a qualified electronic signature (QES) is permissible under the Bill. QES is the highest standard of electronic signature and involves the identity of the signatory being verified by a qualified trust service provider before the signature can be applied. QES offers the highest level of security and evidential value.

This means that, should assignors or providers decide upon using electronic signatures as opposed to wet signatures, they will require to have computer software that facilitates QES (such as that provided by DocuSign). This is distinct to what is known as a simple electronic signature (SES) or an advanced electronic signature (AES), which both have a lower evidential value. Added QES functionality in such software currently comes at extra cost and complexity.

The Committee has recommended that the level of electronic signature required under the Bill be downgraded to a simple electronic signature. It remains the Government’s position that, should it prove necessary or appropriate, there is Ministerial power under section 116(3) to modify the definition of “authenticated”. If, as proposed above, individual consumers will not be granting pledges, then there may be less need to downgrade the signature requirements (because it may be more reasonable to expect businesses to invest in the necessary IT). This matter will, however, also be discussed with the FSB ahead of Stage 2 to ensure that the position of sole traders and start-up businesses is properly considered.

Time is required to evaluate how the registers will be used in practice and the effect the electronic signature provisions might have on uptake before changes can be considered on this point. This matter will be taken forward in conjunction with the Keeper of the Registers who has been conducting research into likely usage of the registers and will continue to do so in advance of the registers becoming operational in the summer of 2024.

Delegated Powers Memorandum

I am happy to confirm that a suitable amendment will be brought forward at Stage 2 to make regulations under section 53(8) subject to the affirmative procedure.

I hope that the Committee finds this response to its Stage 1 Report helpful.

Tom Arthur