



DISCUSSION PAPER SERIES:

PERSONAL PROPERTY SECURITY AND CONSUMERS

PROFESSOR SARAH NIELD

Table of Contents

1	Introduction	1
1.A	<i>The Issues</i>	2
2	The Availability of Finance	2
2.A	<i>Pawnbroking</i>	3
2.B	<i>Bills of Sale</i>	3
2.C	<i>Quasi Security</i>	4
2.D	<i>Future and All Asset Security</i>	5
3	Consumer Protection	5
4	Priority & The Position of Third Parties	6
4.A	<i>Quasi-Security</i>	6
4.B	<i>Bills of Sale</i>	6
5	Conclusion	8

PERSONAL PROPERTY SECURITY AND CONSUMERS

1 Introduction

This brief discussion paper addresses the question of the place of consumers within a notice filing based personal property security regime.

It draws upon the work of the Law Commission in two key papers:

- Law Commission Consultation Paper Registration of Security Interest: Company Charges and Property other than Land No 164 Part VIII (Security Interests created by Non-Corporate Debtors and Registration) published in June 2002 referred to as “CP 164”. The later consultation paper on Company Security Interests (CP176) published in November 2004 and subsequent Company Security Interest Report (Law Comm No 296) published in August 2005, as they names suggest, were restricted to security interests created by companies.
- Law Commission Report on Bills of Sale Law Comm. No 369 published in September 2016 referred to as “Law Comm 369”.

And the City of London Law Society Draft Secured Transactions Code referred to as “CLLS Code”.

This paper is confined to the position of consumer debtors. It does not consider the position of business unincorporated borrowers such as sole traders and partnerships whose position is also considered in CP 164, CP 225 and the CLLS Code. The inclusion of unincorporated borrowers within a notice based personal property regime raises slightly different issues with the result that their inclusion within any reform, whether of a notice-based filing regime or of bills of sale, is generally accepted as desirable.

A legislative definition of consumers is found in the Consumer Rights Act 2015 s 2 – “a consumer means an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession” and is adopted for the purposes of this paper. It contemplates the difficulty that can sometimes arise in separating private and business purchases for instance where a car or computer is purchased primarily for private purposes but may also be used within a small business. The definition is slightly wider than that generally adopted in European consumer initiatives which excludes reference to

business related transactions (see R Manko, 'Notion of a 'consumer' in EU Law' Library Briefing of European Parliament (2013) available at

[http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130477/LDM_BRI\(2013\)130477_REV1_EN.pdf](http://www.europarl.europa.eu/RegData/bibliotheque/briefing/2013/130477/LDM_BRI(2013)130477_REV1_EN.pdf)

1.A THE ISSUES

This discussion paper identifies three key issues when considering the position of consumers within any personal property security regime and around which the paper is structured. These are:

- Availability of finance to consumers secured on personal property;
- Consumer protection; and
- The position of third party purchasers.

2 The Availability of Finance

Reform of any personal property security regime is generally advanced on the basis that it will facilitate and thus open up the availability of finance to business whether conducted by incorporated or unincorporated associations. This basic premise is not necessarily a given when considering consumers. There is a delicate balance to be drawn between providing access to finance to consumers and providing safeguards against over indebtedness. CP 164 noted a concern to guard against consumer over indebtedness in both the Crowther Report and the Diamond Report in this regard - see 10.27. The CLLS Code also expresses concern over the inclusion of consumers as "some of the most controversial provisions of the code" – see commentary to section 21 of the CLLS Code. Whilst the impact of reform of Bills of Sale legislation on indebtedness is not explored in any detail in Law Comm 369, there seems a uniform view from industry and consumer groups that Bills of Sale serve a useful purpose and should not be abolished see 3.34-3.47. The immediate focus of the proposed reforms is upon increasing much needed consumer protection.

Regulatory reform may encourage the growth of security over personal property or, particularly in relation to vehicle mortgages, discourage the use of Bills of Sale as a means by which financiers have avoided the protections afforded to consumers by the Consumer Credit Act 1974. Consumer protection has developed since the Crowther and Diamond Reports and thus the risk of exploitation of consumers may not be as great as once feared – see 3 below. The availability of more accessible forms of security over personal assets could have a beneficial effect on the costs of credit, when compared to unsecured credit for instance offered by Payday lenders, although such savings are likely to be offset, at least in part, by increased transactions costs. Wider consultation would be needed to gain an insight on how both reform of security interests over personal property and the introduction of notice filing might affect the delicate balance between access to finance and over indebtedness. Law Comm 369 does provide insights from industry, practitioners, consumer groups and other experts in the context of the reform of Bills of Sale and thus provides a very useful consultative base. Whilst reform of security interests available to consumer could have a significant impact, notice filing may have little.

In the meantime, it is useful to draw an overview of the present legal framework governing security over personal property to support consumer borrowing noting the key issues that may need to be addressed. This overview, in common with the CP164 and Law Comm 369, is limited to tangible property. This is a practical limitation.

Intangible property is not thought to be a significant source of security for consumer borrowers. Consumers are unlikely to hold a constant and sizeable number of debts to make receivables financing viable. Consumers might wish to use corporate investment securities, in the form of shares and such like, as security but it would seem incongruous to contemplate notice filing of security over such assets when they are largely excluded from registration requirements when created by a non-natural debtor – see Financial Collateral Arrangements (No 2) Regulations 2003, SI 2003/3226.

The one exception maybe the intellectual property rights that could be held by certain individuals, although a comparatively narrow group for instance: artists, authors, musicians, inventors. Security interests over such intangibles by private individuals thus might well be considered business, as opposed to purely consumer, borrowing and benefit from the advantages of reform proposed. They will not be separately considered in this paper.

2.A PAWNBROKING

Pawnbroking is as prevalent as it has ever been in providing access to finance secured on existing property. Indeed it has adapted to modern times by developing both a higher end market presence by providing liquidity to high asset worth borrowers and an on line presence. Employing the possessory security device of the pledge does not present either the classic concerns of personal property security, namely the appearance of false wealth, or priority challenges. The general rules of a legislative regime for personal property, for instance the attachment, enforcement and priorities, would apply to pawns although the possessory nature of pledges avoids issues surrounding attachment of security interests over future property or the need for a right to possession by way of enforcement. Perfection would continue to be effected by possession, rather than registration, although registration could be an attractive alternative for instance where the pledged property is returned to the debtor for a limited purpose.

2.B BILLS OF SALE

Non-possessory security provided by individuals and unincorporated entities falls under the much reviled Bills of Sale legislation. The most common form of non-possessory security by consumers that is subject to the present Bills of Sale legislation are log book loans to raise finance for the purchase of motor vehicles. The finance industry has become familiar with the documentation and registration pitfalls of the Bills of Sale legislation. They have also utilised and developed industry asset finance registries, such as HPI, Experian and Cheshire Datasystems Ltd, as an additional registration practice to record title information on vehicles. Financiers and purchasers are thus able to conduct vehicle provenance checks by searching at these registries. Accordingly there has been a growth in log books loans often to the detriment of consumers – see below.

Bills of Sale on goods other than motor vehicles are not as common given the inherent problems of decline in value of the security from disrepair, loss or depreciation. Certain high value items – such as art, antiques, jewellery or wine – can provide viable security however. CP164 suggests that consumers should be able to raise finance more easily on the security of existing high value personal property than having to pawn or sell such assets – see 10.27-10.31. Ship, including yachts, and aircraft are subject to their own specialist registries and do not all within Bills of Sale regulation. Agricultural charges over farm animals and agricultural assets to secure sums owed to banks likewise are subject to a distinct agricultural charge regime. Law Comm 369 proposes no change to these special security contexts – see 4.40.

Law Comm 369 provides a detailed exploration of the Bills of Sale legislation and proposals for repeal of the current legislation and replacement by a new Goods Mortgages legislation – see Chapter 4. Key features of these reforms propose a new legislative framework which includes:

- Simplified mortgage documentation to create a goods or vehicle mortgage, whether by way of charge or assignment;
- A statutory regime for the regulation of goods and vehicle mortgages defining for instance grounds of repossession and containing prohibitions on security over future property and the possibility of prohibiting security over certain household assets;
- Retention of the requirement for execution of a goods or vehicle mortgage to be signed by the borrower and witnessed;
- Clear interface with consumer protection regimes;
- Registration as a perfection requirement to ensure enforceability against a trustee in bankruptcy or third party. Registration of a vehicle mortgage would be with a designated asset finance registry rather than the High Court. Simplified registration at the High Court would be retained for a goods mortgage but could be replaced if more suitable registries were introduced for instance a notice filing electronic registry.
- Overhauling the rights of the financier to enforce a vehicle or goods mortgage to provide more protection to consumers, in particular detailed provisions as to when a court order is required to repossess a vehicle or goods.
- To provide consumers with a voluntary right to terminate a vehicle or goods mortgage.

2.C QUASI SECURITY

The problems surrounding Bills of Sale have facilitated the development and growth of quasi security in the form of hire purchase and conditional sale as the most common forms of finance for the purchase of personal property by consumers. Sale and leaseback provides an alternative mechanism to raise finance on a consumer's existing goods.

The complexity of these mechanisms to consumers is off-set in some measure by regulation afforded by consumer protection legislation outlined below.

Although registration of these quasi security mechanisms is not required by law, it is common practice for them to be recorded in an asset finance registry where the hire purchase or conditional sale agreement relates to the purchase of a vehicle, caravan, motor home or boat.

2.D FUTURE AND ALL ASSET SECURITY

CP164, Law Comm 369 and the CLLS Code all suggest that consumers should not be permitted to create security over their future property or over all their existing assets. These are policy based prohibitions to provide protections against consumer overindebtedness.

3 Consumer Protection

The conduct of consumer lending is heavily regulated primarily through the Consumer Credit Act 1974 (as amended in 2006) by the Financial Conduct Authority (FCA) as the primary regulator. Regulation operates as several levels:

- Authorisation of providers by the FCA under the Financial Services and Markets Act 2000;
- Setting of business standards through higher level principles eg to treat customers fairly and detailed conduct of business rules (see the FCA, CONC Handbook), in particular to require information disclosure, standard documentation, responsible lending standards and enforcement processes;
- Monitoring and disciplinary powers of the FCA.

In addition consumers, borrowers may seek the assistance of the Financial Services Ombudsman (FSO) in the resolution of disputes with their credit provider rather than going to court. In resolving disputes the FSO need not apply legal rules but may reach a decision on fair and reasonable grounds.

The fairness and clarity of consumer credit terms, save for the interest rate as a core term, is required by the Consumer Rights Act 2015. Its compliance is primarily the responsibility of the Competition and Markets Authority and the FCA.

Finally, industry bodies including the Consumer Credit Trade Association (CCTA), also set industry standards with which they expect their members to comply.

No doubt some rationalisation of this complex regulatory web is desirable if only to provide much needed clarity to consumers. The CLLS Code provides that enforcement powers between the credit provider and the consumer should be subject to existing rules protection consumers – see section 44. However, a more detailed consideration of consumer protection within consumer credit is beyond the scope of this paper. What is important to note however is that this regulation is largely directed at the relationship between the credit provider and the consumer and not at their respective relationships with third parties.

A further discussion on the paucity of consumer protection in the enforcement of Bills of Sale is also necessary. These are explained in Law Comm 369 – see Chapter 7. Particularly problematic are:

- oversight of forbearance. The Bills of Sale legislation only requires the service of a 14 days default notice before enforcement although both CONC and CCTA guidelines require financiers to approach default with forbearance with consideration being given to achieve an alternative repayment plan if possible.

- the lack of court oversight of the enforcement process. The financier under a Bill of Sale may simply repossess the goods using their own staff or an agent and thereafter sell the goods after 5 clear days during which the borrower may apply to court to restrain any sale;
- the lack of any legal right to voluntary termination whereby the borrower may return the goods upon default without further liability. The CCTA code however does recommend voluntary termination where appropriate.
- the lack of any limit on enforcement costs recoverable from the borrower.

Law Comm 369 recommends reforms to address these issues, in particular a legal right to voluntary termination, provisions governing when a court order is required for enforcement, control over the recovery of enforcement costs. These recommendations would bring vehicle and goods mortgages largely into line with hire purchase consumer protection.

4 Priority & The Position of Third Parties

The position of purchasers acquiring personal property that is subject to security from a consumer is dependent upon the type of security. The CLLS Code provides as a default provision that consumers should not be entitled to dispose of assets subject to an existing security interest (see section 24.2(b)).

Pawns for these purposes are not practically an issue. The borrower will not have possession of the property and thus is not generally in a position to sell and transfer ownership. It is the present distinction between the position of a purchaser of property subject to a Bill of Sale and a quasi security interest that raises concerns.

4.A QUASI-SECURITY

An innocent purchaser of property subject to a hire purchase or conditional sale agreement will obtain good title – see sections 27-29 Hire Purchase Act 1964. Industry vehicle providence checks have not yet become expected of a reasonable purchaser and thus will not provide constructive notice. It maybe that, if checks became cheaper and more accessible, they would become the norm and fall within constructive notice.

4.B BILLS OF SALE

By contrast a registered Bill of Sale is binding upon a purchaser. Yet a search of the High Court register is neither easy nor practicable. It is thus no surprise that very few purchasers do so. An innocent purchaser of a car subject to a log book loan may thus find what they thought was ‘their car’ legally repossessed from their driveway with no grounds or opportunity to dispute their loss.

Law Comm 369 suggests reform that would see this unjustifiable distinction between quasi security and Bills of Sale removed but with a possible future qualification in respect of vehicle mortgages – see Chapter 8. They propose that a private purchaser of property subject to a goods mortgage who acts in good faith and without notice of the mortgage should acquire good title. This protection would operate notwithstanding registration of the goods mortgage at the High Court. Law Comm 369 does suggest imposing a legal duty on a

borrower to disclose a goods mortgage when selling the goods. A financier would thus have to go to court to prove notice or bad faith to recover against mortgaged assets in the hands of a private purchaser.

The Law Commission favours the same protection where a private purchaser buys a car subject to a vehicle mortgage. However, following representations from financiers they are prepared to concede that, if the industry made vehicle provenance checks free (or almost free) and more accessible so that they become routine when purchasing a vehicle, it should be possible to move to a position where a purchaser who failed to undertake such a check would not be protected. If it became the norm that a private purchaser should carry out such checks, the position of a private purchaser buying a car subject to either a hire purchase or a vehicle mortgage could then become much the same.

CP164 considers whether security or quasi security interests created over personal property by consumers should fall within a notice filing system to be effective against a trustee in bankruptcy or third party purchaser – see 10.33-10.50. Whilst previous personal property security reports (namely the Crowther and Diamond Reports) were against notice filing in this context, CP164 takes a rather more favourable position in the light of recent developments. The arguments against notice filing include:

- The expense and inconvenience for what are generally small loans over consumer goods that are not often subject to resale;
- The problem of accurately identifying items of personal property;
- The undesirability of clogging up registers with numerous small consumer loans;
- The fact that it is unrealistic and unreasonable to expect consumers to search technical registers.

CP164 notes a number of developments that may justify a re-evaluation of this position. Firstly the increasing number of high value goods acquired on credit, secondly the growth of the second hand market through for instance on-line platforms of which Ebay and Gumtree provide examples, thirdly the development of IT to facilitate large databases as well as the ease of searching, fourthly easier identification of some valuable consumer goods through serial numbers eg electronic equipment and lastly the attraction of creating security over existing high value personal property in addition to purchase money security. They also note that some existing personal property security regimes in other jurisdictions eg New Zealand, Australia and in Canada do not exclude security created by consumers.

CP164 at 10.50 thus suggests the following options:

EITHER

- Filing of security interests over consumer goods should not be possible thus an unfiled security interest would 1) bind a consumer's trustee in bankruptcy BUT 2) a purchaser would not be bound unless the purchaser has actual notice of the unfiled security interest.

OR

- Filing should be required to ensure consumer security is valid against 1) a consumer's trustee in bankruptcy AND 2) any purchaser unless they have actual knowledge of an unfiled security interest.

OR

- Filing should be required to ensure a consumer security is valid against 1) a consumer's trustee in bankruptcy AND 2) a trade purchaser BUT iii) a private purchaser would not be bound by a filed interest unless they had knowledge of the filed security interest. CP164 expresses a preference for this option.

This option also reflects the proposals contained in Law Comm 369 in relation to Goods and Vehicle Mortgages. They must be respectively registered at the High Court and with a designated asset finance registry to be capable of binding a trustee in bankruptcy or other third party.

CP 164 outlines special rules for security interests over vehicles which also reflect in some measure the proposals for log book loans in Law Comm 369:

- Vehicle security interests be registrable regardless of the nature of the borrower;
- An unfiled interest is invalid against 1) a consumer's trustee in bankruptcy AND 2) a purchaser *regardless* of their knowledge;
- A filed interest is binding upon 1) the debtor's trustee in bankruptcy AND 2) a trade purchaser or creditor BUT should not be binding on a private purchaser unless they have knowledge of the interest.

Consideration should be given to excluding low value goods or loans either from registration completely or requiring registration only to bind a trustee in bankruptcy. Law Comm 369 does not propose to exclude small loans from its proposed legislative framework – see Chapter 4.

The CLLS code suggests that security interest by consumers should not fall within the registration provisions – see section 26. This position has been taken because their recommendations build upon the existing regime for the registration of company charges and they are not convinced that there is benefit in extending this regime to consumers. The CLLS Code does acknowledge that, if a new registration regime was introduced, there would “be much to be said for applying it to all chargors” including consumers – see Commentary [7]-[11] on s26.

5 Conclusion

It is important to note two interlinked concerns in considering reform of personal property security affecting consumers. First is the reform of security instruments available to consumers, most notably Bills of Sale, and secondly what the functional approach inherent within notice filing might have to offer to in terms of the priority of security interests over personal property both bought by and sold to consumers.

The law governing Bills of Sale as a security instrument available to consumers is clearly in need of reform and Law Comm 369 makes sensible interim proposals in this regard. It does not however touch on more fundamental reform considered by CP164 or the CLLS Code.

In relation to the priority of security instruments Law Comm 369 retains the need to register what would be vehicle mortgages and goods mortgages but in different registries. The introduction of notice filing would provide an opportunity for all mortgages of personal property by consumers to be brought within a single registry.

CP164 and the CLLS Code also lean in favour of a functional approach to security over personal property by consumers. Personal property security legislation would provide an opportunity for all personal property security devices, both real and quasi, to be governed by a single regime. Where they differ is in the desirability for registration of non-possessory security by consumers to govern perfection and priority. The CLLS Code, in suggesting prohibiting both registration of security interests by consumers and its subsequent disposal, avoids sensitive issues. CP164 favours registration by notice filing of non-possessory security by consumers to be brought within a common registry. Possession, as an alternative method of perfection of possessory security, would be retained with notice filing as a convenient additional means of perfection.

However, whilst recommending registration, both CP164 and Law Comm 369 favour a position where consumers purchasing personal property subject to an existing security interest should take free of that security regardless of registration unless they have notice. In essence, it appears that their preferred position is that the protection afforded to consumers by the Hire Purchaser Act 1964 is retained and extended to all non-possessory functional security devices including Bills of Sale. Filing would then make little difference to the position of consumers purchasing property subject to an existing security interest.

Notice filing could however make a difference in the event of a consumer's bankruptcy and in the sale or mortgage of consumer's personal property to a trade buyer or financier. The key issue then becomes one of evaluating whether the clarity and certainty filing would provide is of sufficient importance to justify the time and expense involved. The voluntary registration of quasi-security devices over motor vehicles is common practice which would suggest that the financing industry does see merit in recording their security.

PROFESSOR SARAH NIELD

22ND DECEMBER 2016