**Perfection and registration of security**

This element explains how you perfect security (including the process of registering security at Companies House) and why this is important. It also addresses priority between competing security and some other legal issues to consider when taking security.

**What is perfection of security?**

Where the lender has physical control of the secured assets, it is usually impossible for third parties to acquire rights over those assets without the lender’s knowledge. Accordingly, it is generally held that the best way to secure an asset is to take possession of it (e.g., to take security by way of pledge).

Where a borrower is still in possession of the secured assets, the borrower may try (fraudulently) to sell them – to help protect a lender from such a scenario there is the process of ‘perfecting’ the security.

This is done so by bringing the security interest to the notice of third parties and helps to overcome the problem that equitable security interests (which will include all fixed charges) can be ignored by a bona fide purchaser (including a subsequent lender) for value without notice.

The manner and method of perfecting security will vary depending on the nature of the security interest taken over the asset and the type of asset.

**What is perfection of security?**

**Perfection methods include:**

- physical possession (as with a pledge);

- transfer of legal or beneficial title to the security holder (as with mortgages);

- notice to a relevant third party (such as to a contract counterparty in the case of assignments by way of security/fixed charges over contractual rights);

- registration at Companies House (in practice this will relate to **all** security); and

- registration with central registries relating to specific assets (such as the Land Registry for charges by way of legal mortgage over land).

We will firstly consider the formalities for registration at Companies House. The main aim of which is to give third parties notice of security and thereby make it valid against their claims.

**Registering security at Companies House**

The Registrar of Companies shall register any security created by a company (or an LLP) at Companies House, provided the requisite statement of particulars of the charge have been delivered to it **within 21 days beginning with the day after the day on which the charge is created** (s. 859A(4) CA 2006).

To register the security, the company or any person interested in the charge (such as the lender) must deliver to Companies House (either electronically or by paper filing, though now mostly electronically) the following:

- a section 859D statement of particulars in relation to the security. This will be set out on **Form MR01** available on the Companies House website;

- a certified copy of the security document (s. 859A(3) CA 2006); and

- the relevant fee.

This is a common trainee and/or junior associate task following the completion of the relevant financing. It is vitally important to attend to registration as soon as possible after the creation of the charge, in case of rejections for minor errors or other mistakes, so as to ensure sufficient time to re-submit documents if necessary.

On receipt of the relevant documents, the Registrar will allocate to the security a **unique reference code** and will include on the register (i) a note of the unique reference code and (ii) the **certified copy of the security document** (s. 859I(2) CA 2006). The Registrar will issue a **‘certificate of registration’** stating the name and number of the company in respect of which the security has been registered and the unique reference number allocated to the security (s. 859I(3)(4) and (5) CA 2006).

This is conclusive evidence that the security has been correctly registered.

Form MR01 is a relatively simple form. As well as including details of the company creating the charge, charge creation date and names of persons entitled to the charge, the Form MR01 only requires a short description of any land, ships, aircraft or intellectual property registered (or required to be registered) in the UK which is subject to a fixed charge.

The rest of the form involves ticking appropriate boxes, including a signature and details of the presenter of the form (this will usually be the lender’s lawyers).

**Consequences of failure to register security**

Under s. 859H CA 2006, if the charge is not registered at all, or is not registered within the 21 day period:

the security is void against the liquidator, administrator and any creditor of the company; andthe debt becomes immediately payable.

As a result of these consequences, registration of security will always be carried out in respect of all types of security created by a company.

In the absence of a priority agreement between creditors, priority between most competing charges of the same type (such as between two fixed charges) is determined by the date of creation, subject to correct registration within the 21-day time period. Accordingly, registration pursuant to s. 859A CA 2006 is very important to retain priority, as well as to prevent the charge being void against other creditors of the company.

Lenders may include a completed Form MR01 as a condition precedent in the loan agreement to which the security relates so that registration of the security document at Companies House can take place immediately after signing.

**How is security released?**

The security document will provide for the release of the security once the secured debt is repaid. There are no strict formalities for the release of security, except for security over registered land for which the requisite form needs to be filed at the Land Registry (see below).

However, it is in a company’s interest to inform Companies House that a secured debt has been repaid and request for the register to be amended to show that the security has been released.

This is so that third parties (such as potential new lenders) searching the register have notice that a prior debt has been satisfied and the relevant security has been released.

To register a release of security, the following steps need to be completed:

- the chargeholder (the lender) should execute a ‘Deed of Release’ and execute any other documents required to release security over specific assets (such as a Form DS1 to release a charge by way of legal mortgage over registered land, which should be registered at the Land Registry);

- the company must deliver to the Registrar, with respect to the registered charge, one of the statements set out in s. 859L(2) CA 2006, being (i) a statement that the debt secured by the charge has been paid or satisfied in whole or in part (using Form MR04) or (ii) a statement that all or part of the property or undertaking charged has been released from the charge or ceased to form part of the company’s property and undertaking (using Form MR05). In addition, the company must include in the relevant form the particulars listed in s. 859L(4); and

- the Registrar, following receipt of either Form MR04 or Form MR05, must include in the register in relation to the released charge (i) a statement of satisfaction in whole or in part; or (ii) a statement of the fact that all or part of the property or undertaking has been released from the charge or has ceased to form part of the company’s property or undertaking (as the case may be) (s. 859L(5) CA 2006).

**Registration requirements for specific assets**

Security over certain assets will need to be registered in other registers **as well as** **being registered at Companies House.**

This relates to the following assets:

- **Land**

- **Shares**

- **Aircraft**

- **Ships**

- **Intellectual property**

**Unregistered Land**

Charges by way of legal mortgage now created over unregistered land trigger compulsory first registration of the land (and mortgage) and will be entered on the Charges Register of the relevant property at the Land Registry (once first registration of the relevant title has been completed).

Charges by way of legal mortgage over unregistered land created **before** compulsory registration will have been created by the deposit of the title deeds and the executed mortgage deed with the lender. They were not registrable at the Central Land Charges Register, but, because the lender had control of the title deeds, the borrower could not deal with the land without the lender’s knowledge. Subsequent (puisne) mortgages of unregistered land should have been registered as Class C(i) Land Charges on the Central Land Charges Register.

**Registered Land**

Charges by way of legal mortgage over registered land should be registered against the title number of the relevant property at the Land Registry (the entry will appear in the Charges Register). Priority is by **date of registration**, regardless of when the security was created (hence the importance of carrying out a priority search and submitting the application for registration of the charge within the 30 working day priority period).

**The Register of Overseas Entities**

Although not strictly related to registration of security, there is a further issue lenders need to be aware of when taking security over a borrower's assets if the borrower is an 'overseas entity'.

Under the Economic Crime (Transparency and Enforcement Act) 2022, an 'overseas entity' (which includes a body corporate, partnership, or other entity that is a legal person governed by the law of a country or territory outside of the UK) that wishes to become the owner of a 'qualifying estate' (which would broadly include UK freehold or leasehold property) must register on the Register of Overseas Entities (the 'Register').

Of particular relevance to debt finance transactions is the restriction on the creation of charges by way of legal mortgage in respect of property where the overseas entity is not correctly registered. Any charge by way of legal mortgage created after 1 August 2022 (subject to certain exemptions) would take effect as an equitable mortgage until such time as the overseas entity is registered on the Register (and receives its unique overseas entity ID).

**Shares**

As a legal mortgage transfers legal title to the shares to the mortgagee, this transfer must be registered in the **register of members** of the company whose shares have been mortgaged (N.B. **not** the register of shareholders of the company **creating** the security over those shares). In other words, the lender (or its nominee) will appear in the register of shareholders as the owner of the legal title to the shares. Note that beneficial interests cannot be noted on the register so no such registration is required for an equitable mortgage or fixed charge over shares.

**Intellectual Property**

The following registers will be relevant:

- **Patents -** Register of patents at the Intellectual Property Office.

- **Registered designs -** Register of designs at the Intellectual Property Office.

- **Registered trademarks -** Register of trademarks at the Intellectual Property Office.

Actual knowledge of an earlier registered charge in the Charges Register at Companies House will prevent a subsequent lender from taking priority, even if the subsequent lender’s charge is registered at the Intellectual Property Office before that of the earlier created charge.

**Aircraft**

Mortgages over aircraft should be registered in the Register of Aircraft Mortgages with the Civil Aviation Authority.

Priority is by date of registration, regardless of when the mortgage was created.

**Ships**

Under the Merchant Shipping Act 1995, mortgages over ships are registered with the Registry of Shipping and Seamen in Cardiff.

Priority is by date of registration, regardless of when the mortgage was created.

**Perfection of assignments by way of security/fixed charge over contractual rights**

Assignments by way of security over contractual rights are perfected by giving notice to the contract counterparty/debtor in accordance with s. 136 LPA 1925. Under the **Dearle v Hall** **rule**, the priority of assignments by way of security is generally determined by the date upon which notice is given to the contract counterparty. A notice to the counterparty/debtor will often also be given in relation to a fixed charge over contractual rights.

However, the requirement to serve notice on all the contract counterparties could be administratively difficult. Accordingly, a lender may have to accept that a notified assignment is commercially impracticable. A compromise position may be for the borrower to sign the notices and to deliver them to the lender at the time the security is granted but for the lender to agree only to deliver the notices to the contract counterparty following an Event of Default under the terms of the finance documents.

**Priority between competing security over same asset**

If a borrower enters into a liquidation or an administration , assets will be sold and the proceeds of sale divided up among the creditors in accordance with the rules of priority.

In general, secured creditors will rank ahead of unsecured creditors. As between different secured creditors holding fixed or floating charges over the same asset which have been registered at Companies House, priority is, subject to some caveats, as follows (on the assumption that each security interest has been registered within the prescribed time and in the prescribed manner):

- fixed charges will have priority over floating charges (even if the fixed charge is created AFTER the floating charge);

- fixed charges (and mortgages) will as between themselves rank in priority according to their date of creation; and

- floating charges will as between themselves rank in priority according to their date of creation.

However, the following exceptions may apply:

- for security over assets requiring registration in a specialist registry (e.g. registered land at the Land Registry), this must be done in addition to registration at Companies House. In this case, it is usually the date of registration in the specialist registry which determines priority;

- a lender taking a floating charge can avoid losing priority to a later fixed charge holder by including a negative pledge in the security document containing the floating charge. The Form MR01 includes a box to tick ‘Yes’ or ‘No’ to indicate whether or not the terms of the security include a negative pledge. There is an argument that any new lender which carried out a search at Companies House would have actual notice of the negative pledge and hence any new security granted to them (in breach of the negative pledge) would not have priority over the prior floating charge;

- creditors may enter into contractual arrangements to change the order of priority the law would otherwise impose (e.g. an intercreditor agreement/deed of priority); and

- in the case of assignments over chose in action, e.g. contract rights, priority is dictated by the date on which notice is given to the relevant counterparty, rather than the date of creation – this is the rule in **Dearle v Hall**.

**Other points to consider when taking security**

**Financial assistance**

**Corporate benefit**

**Corporate power and authority**

**Maintenance of capital**

**Financial Assistance** - where a loan is being provided to finance an acquisition of shares, depending on the nature of the proposed security and/or quasi-security and the details of the overall transaction being contemplated, there could be financial assistance issues arising for public companies and private companies that are subsidiaries of public companies.

Please refer back to the materials and examples of financial assistance considered on the SQE Business Law Preparation course.

**Corporate power and authority** – additional questions should be asked relating to the company’s power to enter into any security, such as does the company have the corporate power to enter into the security and/or quasi-security document? Before taking any security, you need to check for any restrictions in the company’s Articles of Association. If there are any such restrictions, a **special resolution** will be needed to amend the company’s Articles of Association in order to permit it to do so, before the security is granted. The bank will also want to see copies of any such resolutions and any amended Articles of Association, as well as board minutes approving the execution of the security document. These will be required as conditions precedent in the loan agreement.

**Corporate benefit** - the lender should ensure the company granting the security (and/or quasi-security) derives some corporate benefit for the purposes of s.172(1) CA 2006 (the duty to promote the success of the company). This is particularly important where the company is not the borrower, for example where the security is being given by a subsidiary in respect of its' parent's obligations (‘upstream’) or in respect of the obligations of another company at the same level in the group (‘cross-stream’). Common conditions precedent to the financing are board minutes and resolutions confirming that the directors of the company have considered this issue.

**Maintenance of capita**l - if a subsidiary gives an upstream guarantee or security to guarantee or secure a loan made to its parent, then this will not result in a breach of the capital maintenance rules if the directors of the subsidiary consider in good faith and on reasonable grounds that the parent is likely to be able to repay or refinance the loan when it falls due for repayment (and so the guarantee or security is not likely to be enforced). If this is not the case, then the guarantee or security may be treated as a distribution for which the company must have sufficient distributable profits so that there will be no unlawful reduction in its capital. A lender will want to see evidence that the directors of the subsidiary giving an upstream guarantee or security have considered capital maintenance issues and concluded that the guarantee or security is not likely to be enforced and, therefore, no provision need be made in the subsidiary’s balance sheet. Usually, a lender will want to see a certified copy of the board minutes or written resolutions of the directors and a certificate addressed to the lenders/agent, or a representation in the loan agreement, that the guarantee or security will not reduce the subsidiary’s net assets by more than its distributable profits.

You will have looked at the doctrine of maintenance of capital on the SQE Business Law Preparation course.

**Summary**

• Perfection of security is vital in protecting a lender’s interests as it ensures third parties are aware of the lender's security interest.

• Methods of perfection will depend on the nature of the asset and the security interest being created.

• Certain charges must be registered at Companies House, though in practice all security will be registered at Companies House. This is essential as correct registration will determine priority between competing creditors (in the absence of a priority agreement between the creditors).

• Other points which need to be considered when taking security include financial assistance, corporate power and authority, corporate benefit and maintenance of capital.