Professor Andrew J M Steven

SCHOOL *of* LAW
The University of Edinburgh
Old College
South Bridge
Edinburgh EH8 9YL

Stuart McMillan MSP
Convener
Delegated Powers and Law Reform Committee
Scottish Parliament
T1.01
Chamber Office
EDINBURGH
EH99 1SP

26 October 2022

Dear Mr McMillan

MOVEABLE TRANSACTIONS (SCOTLAND) BILL
CONSUMER ISSUES

1. Introduction

I have watched and read the evidence given to the committee on 4 October 2022.

At the outset, I want to stress my agreement that consumer protection is of the utmost importance. The Scottish Law Commission has a long history of work in this area. For example, it helped prepare the Consumer Rights Act 2015 and at an earlier stage it assisted with the legislation which replaced warrant sales.

When working on the Report on Moveable Transactions (Scot Law Com No 249, 2017) we spent a considerable amount of time on the issue of consumer protection.

This can be seen from the number of specific provisions in the Bill.

> Section 7: ban on assigning wages or salary
> Section 48(2): need for separate identification of property for statutory pledge
> Section 48(2): ban on creating statutory pledge over future property, other than in respect of acquisition finance
> Section 48(3): financial threshold in respect of consumer property
> Section 52: acquisition in good faith for personal, domestic or household purposes

Section 53: acquisition in good faith of motor vehicles
Section 54: occupancy rights of spouses and civil partners
Section 63: pledge enforcement notice and the 1974 Act
Section 64(2): court order needed for enforcement
Section 64(3) to (5): protection for residences
Section 65(6): recovery of possession from individuals
Section 71: ban on appropriation.

Many of these provisions are influenced by comparator legislation in other countries or international instruments dealing with security over moveable property.

The evidence given to the committee from Mr Dailly, Mr Fitt and Mr McIntosh was that this is insufficient. Their view is that protection of consumers requires consumers to be removed entirely from the Bill.

Unfortunately the evidence showed some misunderstandings of the Bill and the need for reform. I am therefore writing to you because it is important to clarify the position. I would like also to say something in conclusion on policy.

2. Assignation: registration as an alternative to assignation

The witnesses argued that intimation should continue to be necessary to complete an assignation where a debtor is a consumer.

Under the current law intimation has two principal functions.

(i) To complete the transfer to the assignee. This can be referred to as the *transfer* function.

(ii) To notify the debtor to pay the assignee. This can be referred to as the *notification* function.

The Bill would make registration an alternative to intimation as regards the *transfer* function but not the *notification* function.

Under the Bill, consumers would therefore still require to be notified directly before they could be expected to pay the assignee. Mr Fitt said “Morally, it is the right thing to do – it is the right thing to do practically, too.” I agree. But that is about notification *not* transfer.

Mr Dailly stated:

> “The Financial Conduct Authority is empowered to make rules and it has made the consumer credit rule book, which requires that consumer credit agreements be intimated to the consumer on assignation. If the bill were to be passed as drafted, we would have the absurd position in which consumers would be protected in certain circumstances but not others, which is not logical.”

In fact article 6.5.2 of the rule book only requires notification where the arrangements for servicing the debt change, that is to say where the assignee wants to collect the debt. In other words, the book requires intimation only to fulfil the *notification* function, not to fulfil the transfer function. Often the assignor will continue to collect as agent for the assignee. Elsewhere in the UK where the rule book equally applies, the debt already transfers without any requirement of notification. The Bill will bring the position in Scotland into line with this. The inconsistency in the treatment of consumers therefore does not arise.

Further, the requirement of intimation for transfer under the current law is so backward that it is, in practice, avoided. Assignation of debt is done by expensive workarounds such as trusts or using English law where intimation is not needed to transfer the debt. This happens at the moment with no apparent consumer prejudice. The assignor continues to collect the debt as the assignee's agent but the assignee is protected if the assignor becomes insolvent.

In summary, the Bill brings Scots law into line with the rest of world in not requiring intimation for transfer. Neither Professor Gretton nor I am aware of any legal system that still has this rule.

Mr McIntosh gave a helpful practical example in relation to debt arrangement schemes. He said: "Obviously, if we do not know who the creditors are, how do we make them an offer?" If there has been an assignation but no notification, the offer would made to the assignor, who is the only creditor the debtor knows about. Here, where repayments are being made to the assignor, it is acting as the assignee's agent and will need to take instructions from the assignee in relation to the offer made. As per article 6.5.2 of the rule book, notification is only needed where the arrangements for servicing the debt change. I can readily accept that it is problematic for a money adviser trying to organising a debt arrangement scheme if a creditor does not respond but that equally may happen if there has been no assignation.

If Part 1 of the Bill were to be amended to provide that in assignation of consumer debts intimation is still required for transfer, this would be a hugely backward step. It would effectively frustrate the new legislation. Moreover, it would not achieve what the witnesses want. Consumer debt would continue to be assigned without intimation using the workarounds described above.

3. Statutory pledge: empirical evidence

Mr Dailly said:

> "I am not aware of any empirical evidence that establishes a real business case for the bill for businesses; I have yet to see such evidence."

I would refer to the response to the committee's consultation by Professor Louise Gullifer of the University of Cambridge:

> "There is a great deal of research showing that a functional and friction-free secured transactions law improves access to finance, both in terms of making finance available to those who could not previously access it, and also reducing the cost of finance. This is particularly critical for businesses of all sizes, including companies and unincorporated businesses. It is also true in relation to consumers, but usually the secured transactions law needs to work hand-in-hand with consumer law to protect the interests of vulnerable consumers."

There is also the report by the World Bank of 2019 which both Lady Paton and I referred to in our evidence.

Further, there is the submission of UK Finance to the committee's consultation:

> "SMEs with assets other than real estate (which can be generally secured by a standard security/fixed charge) will generally suffer increased costs and/or reduced availability of finance compared to what would be available under alternative regimes. … In summary, the absence of first charge security attracts greater risk and thus a higher cost of funding for the lender which will inevitably need to be passed on to the customer business either in whole or in part. Introducing the possibility of having specific security over a range of wider assets - through the Register of Assignations

and the Register of Statutory Pledges - would help close that gap for smaller businesses, in particular."

4. Statutory pledge: a new product

It was said several times that the statutory pledge risked the creation of a new product by predatory lenders which would not be subject to regulation by the Financial Conduct Authority. This is mistaken. The statutory pledge is a "security" within the meaning of s 189 of the Consumer Credit Act 1974. See Report on Moveable Transactions para 27.15. It would therefore automatically be regulated by the FCA and be subject to the 14-day default notice provisions in ss 87-89 of the 1974 Act.

5. Statutory pledge: time orders

Mr Dailly appeared to say that it would not be possible with a statutory pledge to obtain a time order under s 129 of the 1974 Act (as contrasted with hire-purchase). The provision allows a debtor to apply to the court for such an order after service of a default notice. Since the default notice provisions would apply to statutory pledges so would s 129.

6. Sale and hire-purchase back

In his evidence Mr McIntosh noted that logbook loans were already available in Scotland through two transactions (1) sale to the lender and (2) hire purchase back to the borrower. He noted that the Scottish Law Commission had said that this was unduly complex. Mr McIntosh commented that with a smart phone it is now easy to sign up to two transactions.

There is, however, a more fundamental issue. It is probable that the transfer to the lender is invalid because of section 62(4) of the Sale of Goods Act 1979 on the basis that what is happening is a security rather than a sale transaction. The statutory pledge would remove this difficulty.

7. Floating charges

It was suggested by Mr Dailly that extension of the floating charge might be a better solution than the statutory pledge. As explained in my evidence, a floating charge can cover all a debtor's assets. This would be unacceptable for consumers. But for sole traders and partnerships, which are governed by personal insolvency law, it would prejudice employees and unsecured creditors such as consumers because the protections provided by corporate insolvency law would not apply. I doubt that Mr Dailly would support that.

For businesses that can already grant a floating charge, the difficulty is that it has a relatively low ranking. The only way to get a "fixed" security over corporeal moveable property in Scotland is to deliver it to the creditor. Further, apart from the floating charge, security can only be taken in respect of incorporeal moveable property by transferring title to it to the creditor. In contrast in England a "fixed" charge is available. The statutory pledge is the functional equivalent of that.

8. Roman law

Mr Dailly stated:

> "Our Scots law system is based on Roman law, which our common law then replaced, and that is why we never had a non-possessory pledge … so there is a lot to be said for going back to Roman law."

This is mistaken. Roman law permitted widespread use of non-possessory pledges. They were known as "hypothecs" (*hypothecae*). It was the developed law of the medieval period which banned them because of the lack of publicity. The Bill solves this problem of lack of publicity in line with the standard international approach by introducing a register.

9. Consultation with consumer groups

Lady Paton has written to you separately about this and I assisted with that letter.

10. Policy

Let me say something about policy in relation to statutory pledges.

First, there is consensus that consumers deserve special protection in relation to legal transactions. More specifically, vulnerable consumers must be protected from predatory lenders.

This is why there is the Consumer Credit Act 1974 and regulation by the FCA.

Secondly, the nature of a statutory pledge as a non-possessory security necessitates further protections within the Moveable Transactions Bill itself.

Consumers should not be able to grant a statutory pledge over essential property which they cannot afford to lose. This is what lies behind the financial threshold provision (s 48(3)), the provision requiring assets to be separately identified (s 48(2)(a)) and the provision limiting the grant over future assets (s 48(2)(b)).

Limitations as regards types of consumer property are standard in other jurisdictions. In New Zealand under the Credit Contracts and Consumer Finance Act 2003 s 83ZN(1) only the following consumer property (and such other that may be prescribed) is excepted from the grant of a security:

(i) beds and bedding;
(ii) cooking equipment, including cooking stoves;
(iii) medical equipment;
(iv) portable heaters;
(v) washing machines; and
(vi) refrigerators.

In terms of s 83ZN(2), hire purchase in respect of all these items remain possible.

In the Canadian provinces the lists of exempt items often mirror that of items exempt from execution (diligence). But for household items there is typically a *total* figure rather than a figure per item. For example, in Ontario it is currently C$14,180, about £9000.

The policy urged on the committee on 4 October is a blanket ban. All consumers should be prevented from granting a statutory pledge over any moveable property in favour of any lender. Such an approach would leave Scotland out of line with modern international standards as set out by the United Nations, the World Bank and in legislation by just about every other country which has reformed moveable transactions law in recent times.

The justification is based mainly on the experience of logbook loans in England. These happen under the Bills of Sales Acts 1878 to 1891. But to equate the statutory pledge directly with the bill of sale is misleading. The statutory provisions on bills of sales are archaic and require paper registration at the High Court in London. Mainstream lenders unsurprisingly are put off them leaving the field open to sub-prime lenders.

Mr Dailly stated "that logbook loans have taken off in the rest of the UK". In fact in recent years their use has declined. In 2018, HM Treasury stated in its [response to its consultation on goods mortgages] at para 1.16:

> "The number of bills of sale registered at the High Court has fallen from 52,000 in 2014 to around 35,000 in 2016. This compared to 760,000 people taking out a total of 3.6 m[illion] high-cost short-term (payday) loans in 2016. The reduction in the number of bills of sale reflects the increased oversight of the logbook lending sector by the FCA and structural changes to the car finance market caused by the increase in Personal Contracts Plans."

This is reflected by Mr Fitt's comment:

> "Thankfully, the high-cost lending industry is in decline because it is getting regulated and some of the companies are going bust, which is good."

He continued:

> "The bill will be a shot in the arm for the high-cost credit industry, which is always waiting for the next opportunity … Also they will find a product that is beyond the reach of the FCA."

As explained above, the statutory pledge would be automatically regulated by the FCA.

I would commend the written evidence of Bruce Wood as to why there would be benefit to consumers in allowing the granting of a statutory pledge over high value assets subject to FCA regulation. This evidence also explains why mainstream lenders would find the statutory pledge attractive rather than it simply being used by predatory lenders.

If I can assist the committee further I would be pleased so to do.

Yours sincerely

PROFESSOR ANDREW J M STEVEN