

Lending and Taking Security in the UK (Scotland): Overview

by Douglas Gourlay, TLT LLP

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A Q&A guide to finance in the UK (Scotland). The Q&A gives a high level overview of the lending market, forms of security over assets, special purpose vehicles in secured lending, quasi-security, guarantees, and loan agreements. It covers creation and registration requirements for security interests; problem assets over which security is difficult to grant; risk areas for lenders; structuring the priority of debt; debt trading and transfer mechanisms; agent and trust concepts; enforcement of security interests and borrower insolvency; cross-border issues on loans; taxes; and proposals for reform.

Overview of the Lending Market

1. What have been the main trends and important developments in the lending market in your jurisdiction in the last 12 months?

Deal activity has been increasingly robust throughout 2021. The 2019 novel coronavirus disease (COVID-19) global pandemic has had a massive and unforeseen impact on both the Scottish and wider UK economy and consequently, the shape of the lending market.

The Scottish market and economy are inextricably linked with and influenced by developments in the rest of the UK, and the UK economy suffered significantly during the lockdown(s). While many sectors have been affected, retail and leisure in particular, the financial services industry has seen appreciable recovery.

The availability of UK and Scottish Government backed loans, grants and other financial assistance has supplemented the activities of companies and ensured that the lending market has remained active. Although much of that activity may well have been masking the actual state of certain sectors of the economy, there has still been encouraging transactional debt finance activity throughout the last six months; in particular, strong activity in clean energy, acquisition finance and real estate finance.

The other defining topic this year has been the retirement of the London Interbank Offered Rate (LIBOR), which is due to be finalised on 31 December 2021. As a result, loans in the Scottish market are, as everywhere else, transferring to alternative methodologies such as the Sterling Overnight Indexed Average (SONIA) or the Secured Overnight Financing Rate (SOFR), with lower to mid-value deals in many cases moving simply to central bank rates.

Forms of Security over Assets

Real Estate

2. What is considered real estate in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected (that is, made valid and enforceable)?

Real Estate

Real estate in Scotland comprises both land and items affixed to the land, known as fixtures. Permanent buildings are fixtures, and form part of the land on which they are situated. Whether an item constitutes a fixture is determined by reference to:

- The degree of attachment.
- The purpose of attachment.
- Whether the item can be removed without causing damage to the land or buildings.

Title to real estate can be either:

- Heritable (absolute ownership, equivalent to freehold).
- Leasehold (exclusive possession for a defined term in exchange for rent).

Title is either registered in the Land Register of Scotland (Land Register) or recorded in the General Register of Sasines (GRS), which is the historic document-based register of individual title deeds.

Since 1981, all land in Scotland recorded in the GRS has been subject to registration in the Land Register on any transfer of interest for consideration.

It is intended that all land will ultimately be registered in the Land Register. This process is accelerated by the Land Registration etc. (Scotland) Act 2012, which allows the registration of land (or part of land) without the prior application or consent of the owner. For example, an application to register a lease, sub-lease or assignation of an unregistered lease or standard security will trigger first registration of the owner's title (automatic plot registration).

It is not possible to register or record a leasehold interest with a term of less than 20 years. Any lease of lesser duration can be registered in the Books of Council and Session for evidentiary purposes.

Common Forms of Security

Scottish law relating to fixed securities over land is largely derived from statute, primarily the Conveyancing and Feudal Reform (Scotland) Act 1970 (as amended) (Conveyancing Act). The only method of creating a fixed security over land and buildings situated in Scotland is by way of a standard security.

There is no Scottish equivalent to the English equitable charge over land. A standard security will only constitute a security interest from the date of registration at the Land Register, or the GRS, where the relevant area is not subject to Land Registration.

A standard security can only be created over a leasehold interest where the leasehold interest (as originally created) is for a term of at least 20 years.

It is also possible to create a floating charge over real estate in the same way as for any other type of asset (*see Question 2, [Common Forms of Security](#)*).

In taking security over investment property, it is common for the lender, in addition to taking a standard security over the interest in land itself (which by virtue of the standard conditions includes a right on default to enter into possession and uplift rents), to take a separate assignation of the right to rents received from occupational tenants by way of an assignation of rents. This is effectively an assignation in security (*see Question 5, [Common Forms of Security](#)*). The lender can require that rents are either paid:

- To a loan account, as set-off against borrowing.
- At the direction of the borrower, subject to further notice of default.

The assignation of rents does not become effective on signing, but only on intimation to the relevant occupational tenants. There is therefore no effective security until notice of assignation is given.

Formalities

The Conveyancing Act sets out the basic form of standard security, which must be in writing. It provides for the essential elements of the document, and various mandatory terms and standard conditions that apply to every standard security. These standard conditions cover the following matters:

- Maintenance and repair, alterations and planning.
- Observance of title conditions and applicable laws.
- Insurance.
- Letting.
- Default and calling-up procedure.
- Creditor rights on default, including power of sale and foreclosure.
- Right of redemption.

The standard conditions (other than those relating to the exercise of the statutory powers of sale, redemption and foreclosure) usually are varied by agreement between the debtor and creditor.

The two distinct elements of a fixed security in Scotland are the:

- Obligation to pay or perform (personal bond).
- Charge over the property (standard security).

Although the personal bond and standard security are usually granted by the same party, this is not always the case. Where they are granted by different parties, this constitutes a third party charge.

All standard securities must be registered at the Land Register. No effective security is created until registration. The effective date of the standard security is the date of registration rather than the date of execution.

From 1 April 2016 the recording of a standard security in the GRS has no effect. This includes any standard security signed before this date but not submitted for recording at that time. Therefore, any person owning property in the GRS over which a new standard security is granted must submit a voluntary registration application for that property in the Land Register, to allow the creditor to obtain a real right.

Standard securities created by UK companies or limited liability partnerships (LLPs) must also be registered at Companies House within 21 days of their date of creation.

Although a Scottish law floating charge can cover heritable and leasehold property, it does not need to be registered in the Land Register before registration at Companies House.

If the real estate is leasehold, it may be necessary to take other steps for perfection, including giving notice to landlords or tenants.

An assignation of rents created by a UK company or LLP must be registered at Companies House within 21 days of its date of creation. Under Scottish law, the effective date of the assignation is the date of intimation to tenants (*see above, [Common Forms of Security](#)*). However, for registration purposes, the date of signing is the operative date.

On 1 July 2015, Scotland came in line with England and Wales by introducing the Legal Writings (Counterparts and Delivery) (Scotland) Act 2015. This allows Scottish agreements to be signed in counterpart and delivered electronically, providing more flexibility in the signing and execution of Scottish and cross-border loan documents.

Tangible Movable Property

3. What is considered tangible movable property in your jurisdiction? What are the most common forms of security granted over it? How are they created and perfected?

Tangible Movable Property

Tangible (or corporeal) movable property (that is, property that physically exists (other than land or fixtures (*see Question 2, [Real Estate](#)*)) and can be moved) includes:

- Plant, machinery and equipment.
- Aircraft.
- Ships.
- Rolling stock and vehicles.
- Physical stock and inventory.
- Physical work in progress.
- Pictures and jewellery.

Livestock is a special category of movable property (not covered in this Q&A). There are also special rules and special registers for ships and aircraft (not covered in this Q&A).

Common Forms of Security

The most common forms of security granted over tangible (corporeal) movable property in secured lending transactions are pledges and floating charges.

Pledges. A pledge is a security that attaches immediately to the specific asset over which it is granted and prevents the borrower (pledgor) from dealing with that asset other than in close co-operation with the security holder. Pledges are analogous to a fixed security arrangement under English law, such as a shares mortgage.

The holder of a pledge is paid first from the proceeds of the sale of the asset subject to its security (less any costs of disposal).

Because of the practical problems in taking effective pledges over many types of tangible movable property, it is common to rely on floating charges over such property (*see below*).

Floating Charges. A floating charge is a charge granted under the Companies Act 1985 subject to enactment of prospective changes in Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007) that hovers over a changing class of assets, for example:

- All assets of the borrower (chargor).
- All assets of a certain type, such as all stock and work in progress (or inventory).
- All book debts or receivables.

The chargor can deal with the charged assets as normal until the floating charge attaches to them (that is, until it crystallises).

Scottish law does not recognise the concepts of "by notice" or "automatic" crystallisation of a floating charge. A floating charge crystallises into the appropriate form of fixed security only on either:

- Commencement of winding-up of the company.

- The appointment of a receiver or administrator by the floating charge holder (see Question 20, *Floating Charges*).

The disadvantage of a floating charge is that the chargor can dispose of the assets and other creditors can then attach them before crystallisation. In addition, on the chargor's insolvency, the proceeds from the sale of the charged assets must be used to pay its preferential creditors. A specified part of the proceeds is set aside as a fund for unsecured creditors.

Formalities

Pledges. A pledge is constituted by delivery of the relevant property to the security holder. No specific form is required to be used to constitute the pledge. However, the assets must meet the following criteria:

- Identifiable.
- Owned by the pledgor.
- Cannot be sold or otherwise dealt with without the consent of the security holder.

For an effective pledge it is essential that control of the assets is taken by the security holder, its nominee or in certain circumstances a third party who has undertaken to maintain and protect the assets (for example, whisky stocked in a bonded warehouse that agrees to hold it to the order of the security holder).

For this reason, it is usually impracticable to create a fixed security over tangible property if it is needed for the daily business of the pledgor (for example, plant or machinery). In practice, a pledge is used where property is in storage, not moved around or rendered unidentifiable and can only be released from storage with the security holder's consent.

A pledge of tangible (corporeal) movable property does not need to be registered at Companies House.

Floating Charges. Floating charges are created by a charging company or LLP over all of the chargor's property, a category of the chargor's property or a single specific asset. The charge need not extend to the whole property and undertaking of the company, although it usually does. To fall within the definition of a "qualifying floating charge" (to which paragraph 14 of Schedule B1 of the Insolvency Act 1986 (as amended by the Insolvency Act 1986 (Scotland) Amendment Regulations 2020/338) applies), a charge must be over all or substantially all of the assets (*Enterprise Act 2002*).

A Scottish company can grant a floating charge over some or all of its assets (including shares that it does not own yet). The charge will create security over the assets (including on the acquisition of the shares by the company).

The legislation does not provide for a specific form of floating charge, although it must be expressly created as a floating charge. A fixed security that was not properly constituted cannot be construed as a floating charge.

A floating charge over any category of property granted by a UK company or LLP must be registered at Companies House within 21 days of its date of creation.

Financial Instruments

4. What are the most common types of financial instrument over which security is granted in your jurisdiction? What are the most common forms of security granted over those instruments? How are they created and perfected?

Financial Instruments

The most common types of financial instrument over which security is granted are:

- Registered shares and securities (both in certificated and uncertificated form).
- Book-entry securities.

Common Forms of Security

Different forms of security are taken, depending on the type of asset:

- **Registered shares and securities.** Fixed security is created by actual transfer of the shares/securities to the security holder or its nominee. Such security is usually referred to as a share pledge.
- **Book-entry securities.** Fixed security is taken in the same way as for claims and receivables, by assignation to the security holder (*see Question 5*). This is because the grantor of the security does not have any direct interest in the securities/debts, but only the right to call on an intermediary or custodian to deliver the securities/debts to its order or sell and account for the proceeds. The assets subject to security are the rights of the grantor of the security against the intermediary or custodian. These rights are more akin to a contractual claim or a debt than an interest in security. Bearer securities are normally subject to a book-entry arrangement with a reputable custodian if they are to be subject to a fixed security.

It is also possible to take a floating charge over shares and securities of all types. In this case, the same rules apply as for tangible movable property (*see Question 3*).

Formalities

The following formalities apply:

- **Registered shares and securities.** The secured shares/securities must be specifically identified and owned by the grantor of the security at the time they are secured. No security right is created unless and until both the following have occurred:
 - transfer is registered;
 - interest of the security holder (or its nominee) is entered in the company's register of members.

The concept of an equitable charge does not exist in Scotland. The parties can enter into a contractual arrangement that binds the borrower, but this would not amount to an effective security and would not bind any future liquidator of the company (*see also Question 2, [Common Forms of Security](#) and Question 8, [Other Assets](#)*).

The decision by the security holder to rely on the contract or to perfect the share pledge will depend on a number of factors, including the value of the associated security and the extent of control that is otherwise available through facility and security covenants.

For example, if a borrowing company's subsidiary holds a material proportion of the assets that are to be secured, then the share pledge is typically perfected to allow for the option to take control of that subsidiary without turning to full security enforcement; if not, the security holder may opt to rely on the contract.

No specific form is required for the pledge document, although it usually regulates the exercise of voting rights, the payment of dividends and other general matters.

When shares are transferred to the security holder, it does not become the holding company of the company issuing the shares in question. However, to avoid any implication that the transferor ceases to be the holding company, it is common to specify that the issuing company should be treated as a subsidiary and the transferor as the holding company within the meaning of the Companies Act 1985 (*section 1159*).

- **Book entry securities.** To create a security, both of the following must occur:
 - notice of the assignation must be given to and acknowledged by the intermediary or custodian;
 - any further steps required under the intermediary or custody arrangements must be taken.

Since the concept of equitable charge does not exist in Scottish law, the right in security is only constituted on intimation, by delivery of a written notice.

Such a security is not subject to any specific statutory form. However, the assets subject to the charge must be identifiable, controlled by the security holder and cannot be sold or otherwise dealt with without the consent of the security holder.

It is not necessary to register a security over shares or securities at Companies House if the security falls within the definition of a "security financial collateral arrangement" under the Financial Collateral Arrangements (No. 2) Regulations 2003 (Financial Collateral Regulations). However, because of uncertainties on the current scope of these regulations, it is common practice to register the security at Companies House within 21 days of its creation by a UK company or LLP.

For the formalities relating to floating charges, see [Question 3](#).

Claims and Receivables

5. What are the most common types of claims and receivables over which security is granted in your jurisdiction? What are the most common forms of security granted over claims and receivables? How are they created and perfected?

Claims and Receivables

The most common types of claims and receivables over which security is granted are debts and rights under contracts.

Common Forms of Security

Fixed security over debts and other contractual rights takes effect by assignment of the security to the security holder. However, in practice, taking a fixed charge over a company's book debts is fairly impractical.

Unlike in England, it is essential to notify all the relevant debtors to create a valid fixed charge. The number of individual debts of a company granting such a charge often means that notifying all the debtors would impose a difficult and almost impossible administrative burden on the chargor.

The preferred route is often therefore to either:

- Take security over book debts by means of a floating charge (see [Question 3](#)).
- Enter into an invoice discounting arrangement.

Where the security holder is the chargor's bank, it is usual to set up a set-off arrangement, which often incorporates a flawed asset provision (that is, the bank and the customer agree that money deposited by the customer with the bank is not repayable until certain events have occurred (usually, repayment of indebtedness due to the bank from the customer)).

There are doubts concerning the effects of an assignment by a customer to its bank of credit balances held with that bank. However, credit balances held with another bank can be assigned.

Floating charges are also used where the debt is a credit balance held with the charge holder or another bank.

Formalities

For an assignment, no security is created unless and until:

- Notice of the assignment is given to and acknowledged by the debtor or other contractual counterparty.
- Any further steps required under the contract in question have been taken.

Since the concept of equitable charge does not exist in Scottish law, the right in security is only constituted on intimation, by delivery of a written notice.

The contract in question may contain provisions restricting assignment and other terms which may be prejudicial to the security arrangement. Some direct arrangements with the counterparty may therefore be necessary.

In addition, the grantor must hold and specifically identify the contract in question at the time the rights arising under it are secured. The rights assigned may also be subject to set-off claims. The security is ineffective if the assignor retains control of the rights assigned or their proceeds.

Security granted by a UK company or LLP over claims and receivables is almost always registered at Companies House within 21 days of its creation, even where the Financial Collateral Regulations do not require registration (see [Question 4](#)).

For the formalities relating to floating charges, see [Question 3, Formalities](#).

Cash Deposits

6. What are the most common forms of security over cash deposits? How are they created and perfected?

Common Forms of Security

The only effective way to take fixed security over cash deposits in Scotland is by way of assignment in security (see [Question 5](#)).

It is possible to take fixed security over a blocked deposit (as is the case in England). However, taking fixed security over current accounts is problematic and rare in practice as a perfected assignment would prevent the borrower from using the account in question. If the borrower is allowed to use the account, there is a risk that the charge will not be considered as a perfected fixed charge.

In practice, it is far more common for a lender to rely on floating charges in respect of current accounts (see [Question 3, Formalities](#)).

Formalities

The formalities for creating and perfecting security over cash deposits are the same as for claims and receivables (see [Question 5, Formalities](#)).

For the formalities relating to floating charges, see [Question 3, Formalities](#).

Intellectual Property

7. What are the most common types of intellectual property over which security is granted in your jurisdiction? What are the most common forms of security granted over intellectual property? How are they created and perfected?

Intellectual Property

Intellectual property (IP) includes:

- Registered IP, including:
 - patents;
 - trade marks; and
 - designs.
- Unregistered IP, including:
 - unregistered trade names or marks;
 - goodwill; and
 - licences over registered and unregistered IP.

Common Forms of Security

Floating charges are commonly taken over IP, as for other forms of property (*see Question 3, Formalities*).

It is relatively rare to take fixed security over IP, unless it is particularly significant in a particular transaction and the disadvantages of a floating charge cannot be addressed adequately in other ways. However, fixed security can be taken over registered IP.

IP licences are treated as contractual rights. Fixed security is taken in the same way as for claims and receivables, by assignment to the security holder (*see Question 5*).

Fixed security can be taken over copyright by assignment. However, there is no clear mechanism to take fixed security over other forms of non-contractual unregistered IP.

Formalities

Floating charges over intellectual property are taken in the same way as for other assets (*see Question 3, Formalities*).

Fixed security over registered IP is taken by transferring the IP in question to the security holder (or its nominee) and registering the transfer in the relevant public register under the relevant statutory regime, such as the Trade Marks Register (*Trade Marks Act 1994*) or Patents Register (*Patents Act 1977*, *Patents Rules 2007* and *Copyright, Designs and Patents Act 1988*).

In practice, assignments are often signed up and delivered as conditions precedent, but not perfected until required by the lender (for example, on default or if default is likely). However, perfection of a security on insolvency may give rise to issues concerning hardening periods, alienations and preferences (see [Question 23](#)). In addition, given the need for the debtor to continue to deal with its IP, fully perfected assignments of IP are rare in Scotland and are generally considered uncommercial.

The relevant IP must be specifically identified and owned by the grantor of the security at the time it is secured. No fixed security is created unless and until the transfer is registered.

The security document usually provides for:

- The manner in which the security holder must deal with its title to the IP.
- A licence back to the grantor of the security to use the IP.
- The management of infringement actions.

Formalities for the assignment of IP licences are the same as for claims and receivables (see [Question 5, Formalities](#)). No security is created unless and until notice of the assignment is given to and acknowledged by the relevant licensor and any further steps required under the licence have been taken.

It is not necessary to give notice of an assignment of copyright. There is no clear mechanism to take fixed security over other non-contractual unregistered IP.

All securities granted by a UK company or LLP over IP must be registered at Companies House within 21 days of their creation.

Problem Assets

8. Are there types of assets over which security cannot be granted or can only be granted with difficulty? Which assets are difficult or problematic when security is granted over them?

Future Assets

It is difficult to create an effective fixed charge over future and circulating assets, as the chargee must have both possession and control of the assets charged. As the concept of equity does not exist in Scottish law, no security interest is created unless further steps are taken to perfect the security once the relevant assets come into being.

However, floating charges over future or circulating assets can be created (see [Question 3, Common Forms of Security](#)).

Fungible Assets

The position is the same as for future assets (see [above, Future Assets](#)).

Other Assets

Some assets, such as leases or contracts, may contain restrictions to the granting of security and other terms that may be prejudicial to the security arrangement. Consents or other direct arrangements with the landlord, counterparty or other third parties may therefore be necessary. These restrictions can invalidate the security and have a prejudicial effect on the asset itself and/or the grantor of the security.

Under Scottish law, an assignation is only effective on intimation or notification of the assignation to a relevant party (such as a third party to a contract) (see [Question 5](#)). It is therefore not possible to create an undisclosed (equitable) assignation.

In addition, there is no concept of equitable charge and distinction between a mortgage and a charge under Scottish law. It is therefore not possible to hold an equitable charge over assets that are located in Scotland.

There is no Scottish law equivalent of the English law chattel mortgage, as a Scottish security over movable property requires actual delivery or delivery to a third party. The only way to take non-possessory security over movable property in Scotland is by way of floating charge (see [Question 3](#)).

Release of Security over Assets

9. How are common forms of security released? Are any formalities required?

A standard security over an interest in land is discharged by means of a statutory form of discharge registered in the Land Register or GRS (as applicable).

Discharges of fixed securities over financial instruments, claims and receivables, cash deposits and IP are effected by transferring the asset in question back to the grantor in the same manner as they were transferred to create the security (for example, by registered transfer of shares, notified re-assignation of debts or registered transfer of registered patents).

A pledge over tangible movable property is discharged by transferring possession back to the grantor of the security, usually in conjunction with a discharge document recording the discharge.

A floating charge is discharged by a deed of release, although no specific form of document is required. Assets subject to a floating charge that are sold by the chargor are automatically released from the charge if the charge has not crystallised. However, the buyer may require a letter of non-crystallisation from the charge holder.

Discharge of a security that is registered at Companies House is normally also notified to Companies House. However, failure to notify does not affect the validity of the discharge.

Special Purpose Vehicles (SPVs) in Secured Lending

10. Is it common in your jurisdiction to take security over the shares of an SPV set up to hold certain of the borrower's assets, rather than to take direct security over those assets?

The position in Scotland is very similar to that in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 10](#)).

Quasi-Security

11. What types of quasi-security structures are common in your jurisdiction? Is there a risk of such structures being recharacterised as a security interest?

Sale and Leaseback

Sale and leaseback of real estate (where the asset is sold to a third party and leased back to the seller at a market rent, effectively releasing capital in a tax efficient way) is relatively common and unlikely to be recharacterised as a security interest. The landlord's title is protected under the general law of landlord and tenant and other provisions of land law.

Sale and leaseback of tangible movable property (where the owner of equipment sells that equipment to a financier who leases it back to the seller) is commonly used. However, there is a risk of recharacterisation as an ineffective security as the seller may give good title to the goods to a third party under section 24 of the Sale of Goods Act 1979.

If the leaseback requires the seller to repurchase the goods or gives it an option to do so, the arrangement may be recharacterised as a loan secured on the goods, with the recharacterised security void if not registered at Companies House. However, the Scottish courts are unlikely to recharacterise these transactions as secured loans without evidence that the parties did not intend the sale and leaseback documents to record their true intentions.

Factoring

Factoring, where a financier effectively buys its customer's receivables, is commonly used. The transfer of receivables for the purposes of factoring is subject to similar debtor notification and other issues to those faced by the taking of fixed security over receivables (see [Question 5](#)).

Trust mechanisms or floating charges are commonly used in factoring arrangements to address these issues.

Hire Purchase

Under a hire purchase agreement, the owner of goods leases them to a lessee and grants the lessee an option to purchase the goods at the end of the lease. Conditional sale agreements are similar to hire purchase, but the lessee must take title to the leased equipment by paying the final rental due.

Both types of agreement are commonly used and unlikely to be recharacterised as a security interest. However, sale or processing by the lessee may defeat the lessor's title.

Retention of Title

Retention of title (where the seller retains title to goods it sells until it receives their purchase price) is commonly used and unlikely to be recharacterised as a security interest. However, sale or processing by the buyer may defeat the seller's title.

Other Structures

Contractual set-off arrangements are enforceable unless inconsistent with the Insolvency Rules 2018 (as amended by the Insolvency (Scotland) Rules 2018 (Miscellaneous Amendments) Rules 2019/1059) and other insolvency laws. The rules impose a mandatory insolvency set-off regime when a company goes into liquidation or is in administration once the administrator has given notice of an intention to make a distribution to creditors.

Close-out netting of a type contemplated by derivatives transactions under an ISDA Master Agreement is generally considered enforceable in Scottish law. If these arrangements were to fail due to inconsistency with the Insolvency Rules 2018 (as amended) (or other insolvency laws), the insolvency set-off regime those rules impose would tend to produce a similar result (but not necessarily identical net figures) to that contemplated by the ISDA close-out netting arrangements.

For bank account set-off arrangements, see [Question 5](#), [Common Forms of Security](#).

Other quasi-security structures are not commonly used in Scotland.

Guarantees



12. Are guarantees commonly used in your jurisdiction? How are they created?

Guarantees are very commonly used in Scotland. Guarantees are not generally required to be in writing (although it is the universal practice to do so), and no specific formalities apply.

The Scottish law on guarantees is otherwise similar to English law. Decisions of the English courts are not binding on the Scottish courts, but are usually considered persuasive.

The Scottish law on cross-stream and upstream security and guarantees is similar to English law. In a cross-group guarantee structure, it must be noted that each member of the group is treated as a distinct legal entity, and its interests are considered separately from those of the group as a whole.

Risk Areas for Lenders

13. Do any laws affect the validity of a loan, security or guarantee (or the terms on which they are made or agreed)?

Financial Assistance

The same rules apply in Scotland as in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 13, Financial Assistance](#)).

From 1 October 2009, prohibitions and procedures on the giving of financial assistance by a private company for the acquisition of shares in itself or another private company were repealed. However, these prohibitions still apply to public companies and their subsidiaries.

Corporate Benefit

A director of a Scottish company has a statutory duty to act in a way they consider is likely to promote the company's success. The position is the same as in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 13, Corporate Benefit](#)).

Where there is a cross guarantee structure, the corporate benefit of the structure in respect of individual members of a group is usually explained and recorded in the company's board minutes, with directors setting out the basis of their belief that the relevant company will derive an individual benefit from the funding provided and the success of the group.

Loans to Directors

The position is the same as in England and Wales (see [Corporate Governance and Directors' Duties in the UK \(England and Wales\): Overview, Question 29](#)).

Usury

There are no usury laws affecting the validity of a loan, security or guarantee.

Others

There are no other laws affecting the validity of a loan, security or guarantee.

14. Can a lender be liable under environmental laws for the actions of a borrower, security provider or guarantor?

The holder of a security over land is not automatically liable for breaches of environmental law. However, if the security is enforced and the security holder takes possession of the land, it can be liable for environmental damage on that land or coming from it, even if it did not itself cause or permit the damage.

The holder of security over land should therefore only take possession of that land after careful consideration of its potential environmental liability.

Securities over other assets, guarantees and loan agreements are unlikely to give rise to environmental liabilities.

Structuring the Priority of Debts

15. What methods of subordination are there?

Contractual Subordination

The position on contractual subordination in Scotland is very similar to that in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 15, Contractual Subordination](#)).

The Scottish courts recognise contractual subordination and subordination on insolvency, subject to the application of any other relevant principles of Scottish law. For example, a contractual ranking arrangement and the priorities established by it may be affected by Scottish rights in security (which are not registrable under the Companies Act 2006), such as landlords' hypothecs and effectually executed diligences.

In addition, if a senior creditor/lender receives intimation (notice) of any subsequent fixed security or floating charge in relation to any of the assets or rights subject to its existing charge, any contractual priority ranking will be restricted to the:

- Advances made before the intimation.
- Advances made after the intimation which the senior creditor/lender is obliged to advance, and any interest and expenses linked to the advances.

Structural Subordination

It is common to use both contractual and structural subordination to ensure that subordination provisions are effective. The position is the same as in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 15, Structural Subordination](#)).

Intercreditor Arrangements

Contractual subordination is normally effected through an inter-creditor or ranking agreement. There are no required forms for such agreements. However, an agreement ranking a floating charge and other securities granted by a Scottish company or LLP must be registered at Companies House within 21 days of it being entered into. Parties to the agreement must include the:

- Company.
- LLP.
- Holders of all securities affected.

An agreement ranking two or more standard securities over the same interest in land must also be registered in the Land Register or GRS (as applicable).

Debt Trading and Transfer Mechanisms

16. Is debt traded in your jurisdiction and what transfer mechanisms are used? How do buyers ensure that they obtain the benefit of the security and guarantees associated with the transferred debt?

The trading of commercial debt is common in Scotland. The position is very similar to that in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 16](#)).

However, equitable assignment of debt is not recognised in Scotland (see [Question 5](#)).

Agent and Trust Concepts

17. Is the agent concept (such as a facility agent under a syndicated loan) recognised in your jurisdiction?

The agent concept is recognised in Scotland. Scottish law recognises the role of a facility agent or security trustee under a syndicated loan and allows the agent/trustee (as opposed to all lenders acting individually) to enforce security and apply the proceeds to the claims of all the lenders.

18. Is the trust concept recognised in your jurisdiction?

The trust concept is recognised in Scotland. However, the Scottish laws relating to trusts have a very different historical background to those in England.

In Scotland, the trust is an effective means of extricating assets from the estate of the trustor/grantor and is commonly used as a means of achieving bankruptcy remoteness in Scottish transactions (for example, securitisations).

A turnover trust is likely to be an effective means of debt subordination, although there is no separate Scottish authority on this. Specific advice on Scottish law should therefore be sought.

Enforcement of Security Interests and Borrower Insolvency

19. What are the circumstances in which a lender can enforce its loan, guarantee or security interest? What requirements must the lender comply with?

Standard Securities

A standard security (see *Question 2*, [Common Forms of Security](#)) can be enforced following "default" within the meaning of the Conveyancing Act.

Default includes:

- Failure to comply with a notice requiring discharge of the debt secured by the standard security.
- Failure to comply with any other requirement arising out of the security.
- The proprietor of the secured asset becoming insolvent.

Default for the purposes of the Conveyancing Act is not necessarily the same as default for the purposes of a loan document. It is possible to amend a standard security to extend the circumstances in which it can be enforced. The right to take possession and sell the secured asset arises if the security provider fails to make payment of any sum demanded within two months of service of a calling-up notice relating to the standard security.

Other Security Interests

The other fixed security interests referred to in this chapter and floating charges can be enforced in circumstances determined in the security document, usually following a defined event of default.

There are statutory grounds for enforcing a floating charge by appointment of an administrator on the basis of (*Schedule B1, Insolvency Act 1986*):

- Specified arrears of interest.
- Expiry of a demand for principal.
- Winding up.
- Receivership.

These grounds can be (and in practice are) supplemented or superseded by other enforcement events referred to in the charging document.

The circumstances under loan and guarantee documentation in which payment becomes due are similar to those in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 19](#)).

Court Action and Diligence

The lender can also seek payment from borrowers or guarantors (or their assets) through a court action and attachment (diligence). This Q&A does not cover court action and diligence.

Methods of Enforcement



20. How are the main types of security interest usually enforced? What requirements must a lender comply with?

Standard Securities

Standard securities over real property are generally enforced by the holder of the security selling the property (see [Question 2](#)).

The sale can be by private contract or public auction. In either case, the property must be publicly advertised for sale and reasonable steps taken to obtain the best price.

The holder of a standard security can also:

- Enter into possession of the property.
- Collect existing and ongoing rents.
- Let the property.

However, new leases can only be created for a maximum of seven years unless a court order authorising a longer lease is obtained.

Other Fixed Securities

The other types of fixed securities (see [Question 2 to 7](#)) are also generally enforced through the sale of the secured asset(s).

However, the methods of enforcement are not as closely regulated as for real estate and are normally provided in broad terms in the security document. Many fixed securities are enforced by transferring title to the security holder or its nominee. Sale and other methods of enforcement of the securities are therefore usually relatively straightforward. They can be carried out by the security holder or its nominee as the holder of title to the asset in question.

However, for pledges over tangible movable property, a clear power of sale must be included in the pledge document. If no such power is included, it is necessary to obtain the court's approval for selling the pledged assets.

A creditor has a duty to maximise value when enforcing all these types of fixed security. However, this duty is less onerous than the one applying to holders of a standard security over real estate (see *above*, [Standard Securities](#)).

Floating Charges

Floating charges can be enforced by appointment of:

- An administrative receiver (for charges granted before 15 September 2003).
- An administrator (for charges granted on or after 15 September 2003), if the lender has security over substantially all of the company's property.

(Insolvency Act 1986.)

The holder of a floating charge over all, or substantially all, of the company's assets can no longer appoint a receiver *(Insolvency Act 1986)*.

Receivers and administrators have broad powers under the Insolvency Act 1986 (*Schedule 1*). These can be adjusted and extended in the charging document. Sale or other disposal as a going concern of the charged assets is not an unusual outcome of receivership or administration. It is common for a business to continue to trade for a period before this takes place.

However, an administrator has a statutory duty to:

- Favour a rescue of the company as a going concern (rather than its disposal).
- Consider the interests of the company's creditors as a whole.

(Insolvency Act 1986.)

While a receiver has a broad duty to maximise value when enforcing a floating charge, this duty is less detailed and onerous than that of an administrator or creditor enforcing a standard security over real estate (*see above, [Standard Securities](#)*).

Rescue, Reorganisation and Insolvency

21. Are company rescue or reorganisation procedures (other than insolvency proceedings) available in your jurisdiction? How do they affect a lender's rights to enforce its loan, guarantee or security?

The corporate rescue and reorganisation procedures are the same as in England and Wales (*see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 21](#)*).

22. How does the start of insolvency procedures affect a lender's rights to enforce its loan, guarantee or security?

The position in Scotland is similar to that in England and Wales. When a company enters administration, it becomes subject to a statutory moratorium, subject to the same restrictions and qualifications. There is no equivalent statutory moratorium during a company's liquidation (*see [Lending and Taking Security in the UK \(England and Wales\): Overview, Question 21](#)*).

23. What transactions involving loans, guarantees, or security interests can be made void if the borrower, guarantor or security provider becomes insolvent?

When a company becomes insolvent, a transaction it has previously entered into can be challenged on the following grounds:

- **Void floating charge (section 245, Insolvency Act 1986).** The same rules apply as in England and Wales (see *Lending and Taking Security in the UK (England and Wales): Overview, Question 23*).
- **Gratuitous alienation (section 242, Insolvency Act 1986).** A gratuitous alienation occurs where any of the debtor's property has been transferred, or any claim or right has been discharged or renounced:
 - for no (or inadequate) consideration;
 - granted by an insolvent grantor; and
 - which has placed a creditor in a better position than it would have been on insolvent liquidation.

A gratuitous alienation can be challenged if the transferor becomes insolvent within two years following the transfer. This period increases to five years if the transferor and transferee were associated. The provisions of the Insolvency Act on transactions at an undervalue do not apply to Scotland (section 238).

- **Unfair preference (section 243, Insolvency Act 1986).** An unfair preference is a transaction, made within six months before the relevant insolvency event, which creates a preference in favour of a creditor to the prejudice of the other creditors (for example, the grant of a security for an old debt on the verge of insolvency, in an attempt to give a creditor a better return on insolvency). The provisions of the Insolvency Act on preferences do not apply to Scotland (section 239).

A security, a guarantee or a loan can be avoided as a preference or gratuitous alienation both under statute and common law.

The position in relation to "hardening periods" is similar to that in England and Wales. These qualifying periods only relate to the occurrence of the insolvency event and do not limit the time during which a challenge can be made, subject to a ten-year limitation period.

To defend a preference or alienation, a creditor must usually prove either that the:

- Transaction was made at full value.
- Debtor was solvent at the time the transaction was completed.

If there is a successful challenge, the remedies are reduction of the:

- Title transfer (or other restoration of the property to the transferor's estate).
- Security document.
- Guarantee (the court can also order the repayment of any amounts already received from the guarantor).

If reduction or restoration is not possible, the court can order other appropriate remedies.

Reduction is not possible if a third party has since acquired title in the property in good faith and for value.

24. In what order are creditors paid on the borrower's insolvency?

The position in Scotland is similar to that in England and Wales (see [Lending and Taking Security in the UK \(England and Wales\): Overview](#)). However, the rules on priority between security interests are different.

The Scottish rules governing the priority between two or more security interests over the same asset can be complex. The basic rule is that security interests rank in the order in which they are constituted (for example, by registration of standard securities in the relevant land register). Registration at Companies House is largely irrelevant to priority (although it is important for the effectiveness of securities against other creditors).

In principle, a floating charge ranks after fixed securities granted over the same assets before the crystallisation of the floating charge. However, it is possible to enter into ranking arrangements giving priority to floating charges over later fixed securities through either:

- Inclusion of negative pledge provisions.
- Separate intercreditor agreements.

(*Companies Act 1985*.)

Notification of a later standard security over real estate (or of a later floating charge) to the holder of a corresponding prior ranking security restricts the prior ranking security to advances already made or committed. Notice of an existing security does not normally otherwise affect priorities.

It can be difficult to create multiple securities over tangible movable property, shares, receivables and certain other types of assets, as they operate, in principle, through transfer of ownership or possession.

If the security interest has not been validly perfected, the security holder ranks as an unsecured creditor.

Cross-Border Issues on Loans

25. Are there restrictions on the making of loans by foreign lenders or granting security (over all forms of property) or guarantees to foreign lenders, or taking guarantees from foreign subsidiaries of the borrower?

There are no restrictions on granting security or guarantees to foreign lenders, or on the making of loans by foreign lenders.

26. Are there exchange controls that restrict payments to a foreign lender under a security document, guarantee or loan agreement?

There are no exchange controls restricting payments to a foreign lender under a security document, guarantee or loan agreement.

27. What regulatory requirements does a UK lender have to comply with to purchase a loan made to a borrower in your jurisdiction?

There is no indication that Scotland will be subject to different regulatory requirements than the rest of the UK post-Brexit. A UK lender should therefore be able to continue to engage in transactions with a borrower in Scotland. However, the final position will depend on what exit position the UK negotiates.

At present, financial legislation across EU member states is harmonised. Passporting rights mean authorised UK financial institutions can provide services within the EU without obtaining a separate licence for each individual state. If the UK negotiates to remain part of the single market, these passporting rights will remain.

However, the exit position remains uncertain. It might therefore be the case that a UK financial institution will require a license to lend and provide financial services in EEA countries after Brexit.

Alternatively, a UK financial institution may decide to move to or establish an operation in an EEA country that would provide that institution with passporting rights. This would have a financial impact on the institution and a negative impact on the UK market if financial institutions presently headquartered or with material presence in the UK decide to move elsewhere.

There is no indication at present that there will be any divergence between Scotland and the rest of the UK in any exit scenario. A UK lender will continue to be able to take a security from a borrower in Scotland.

Taxes and Fees on Loans, Guarantees and Security Interests

28. Are taxes or fees paid on the granting and enforcement of a loan, guarantee or security interest?

Documentary Taxes

No stamp duty (or equivalent) is payable on granting a loan, guarantee or security interest. However, stamp duty may be payable by the purchaser on enforcement of the security (see [Question 20](#)).

Registration Fees

Nominal fees are payable on the:

- Registration of securities at Companies House.
- Registration in the relevant IP registers of fixed securities over registered IP.

Registration of a standard security in the relevant register is subject to a flat rate fee of GBP60 per real estate title.

There is no registration fee payable on the granting or enforcement of a loan or guarantee.

Notaries' Fees

There are no notaries' fees payable on the granting and enforcement of a loan, guarantee or security interest.

29. Are there strategies to minimise the costs of taxes and fees on the granting and enforcement of a loan, guarantee or security interest?

The fees and taxes payable on the granting and enforcement of loans, guarantees and securities are not normally considered sufficiently expensive to lead to mechanisms to minimise or avoid them.

Reform

30. Are there any proposals for reform?

The Scottish law on floating charges will be reformed if Part 2 of the Bankruptcy and Diligence etc. (Scotland) Act 2007 comes fully into force. The main change is that a formally executed floating charge document will need to be registered in a new register of floating charges. However, there is currently no date set for entry into force.

The Scottish Law Commission published a discussion paper on moveable transactions in June 2011 containing a major proposal for reforming security and other transactions regarding certain assets other than land. Implementation of this reform would be likely to significantly affect the responses to [Question 3 to 6](#). The report was published in 2017 and included a draft Moveable Transactions (Scotland) Bill. Among other things, the bill proposes to modernise Scots law by creating electronic registers and recognising electronic intimation. The progress of the bill through parliament was temporarily paused in the last parliamentary session due to the COVID-19 pandemic but has been included in the government's new legislative programme. Reform by the Scottish Government is eagerly awaited.

In September 2021, and as a result of the pandemic, Nicola Sturgeon announced plans for twelve new bills that will be put before the Holyrood Government during the parliamentary year 2021 to 2022, including the COVID Recovery Bill. This has been described as a bill to embed reforms in public services and the justice system that, though necessitated by the pandemic, have delivered improvements. It is so far unclear as to what practice areas may be affected.

The Scottish Law Commission has also been reviewing the current legislation governing standard securities in Scotland. Although work began in 2018, the first discussion paper entitled Discussion Paper on Heritable Securities: Pre-Default was only published on 18 June 2019. This referenced its initial findings, while a second paper on post-default enforcement is expected in late 2020. The 2019 paper discusses whether the 1970 Act remains fit for purpose and considers the creation, variation, transfer and discharge of standard securities, and looks at which types of obligations can be secured. Some major proposals that the paper raises includes abolishing the standard conditions in their current form set out in the Schedule to the Act and consolidating the law on security over land. Implementation of this reform would be likely to significantly affect the responses to [Question 2](#), [Question 19](#) and [Question 20](#).

Contributor profile

Douglas Gourlay, Partner

TLT LLP

T +44 333 006 1516

F +44 333 006 0411

E douglas.gourlay@tltsolicitors.com

W www.tltsolicitors.com

Professional Qualifications. Scotland, Solicitor; England & Wales, Solicitor

Areas of Practice. General banking; real estate finance; project finance.

Professional Associations/Memberships. Law Society of Scotland; The Law Society.

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