Lending to individuals

June 2012

Lending to individuals

Introduction

When lending to an individual borrower, or seeking to obtain a personal guarantee or security from an individual, a lender will need to consider a number of matters, and should take advice from suitably experienced counsel.

This briefing paper sets out some of the relevant legislation, issues and other factors that a lender should consider in financing transactions involving individuals. This paper is aimed at lenders operating in the private wealth sphere and, as such, it does not consider the full scope of regulations and other factors to be taken into account by lenders offering retail banking services to individual customers.

Consumer Credit Act

When is this relevant?

The Consumer Credit Act 1974 (as amended, the "**CCA**") will apply to "consumer credit agreements" between a "creditor" and an "individual". This means that it applies to credit arrangements of any value entered into by a lender with:

- Individuals
- Sole traders
- Partnerships of two or three partners (unless all partners are bodies corporate) or
- Other unincorporated bodies, such as clubs (again, unless they consist entirely of bodies corporate),

in each case wherever they are resident if dealing with a UK creditor and an English law governed credit agreement.

The definition of what constitutes a "credit agreement" for the purposes of the CCA is a broad one and it extends to cover (without limitation) loan agreements, overdrafts, hire purchase agreements, conditional sale agreements, pawn agreements, credit card agreements and other agreements where goods or services are supplied, but payment for which is deferred or credit provided.

It should be noted that it is irrelevant, for these purposes, whether or not interest is charged in relation to any of these arrangements; the CCA may equally apply to, for example, an interest-free loan.

It should also be noted that whilst the position prior to 6 April 2007 (and applicable to agreements made prior to this date) was that credit agreements of a value in excess of £25,000 fell outside the definition of "regulated agreement" under the CCA, this financial limit was removed by the Consumer Credit Act 2006 and there is currently no exclusion for agreements above a certain value (save for those to which the "business purposes" exemption outlined below would apply).

When a lender has established that the relevant credit arrangement is itself one that meets the above criteria, and so falls within the scope of the CCA, the next question to ask is whether the arrangement amounts to a "regulated agreement", or whether an exemption applies.

What exemptions could apply?

When considering whether one of the exemptions applies to a consumer credit agreement (which would take the agreement outside the scope of regulation of the CCA), care must be taken to consider the precise terms of the relevant exemption.

The exemptions that are most likely to be relevant are the following:

- "High Net Worth Individual" exemption.

  This exemption may apply if the borrower or hirer is a natural person with an income (net of National Insurance contributions and income tax) of not less than £150,000 and/or net assets (excluding items such as the value of their primary residence and pensions contributions) of not less than £500,000 in the "previous financial year" (i.e. the financial year ending on 31 March).

  From 1 February 2011, it is an additional requirement under the CCA that the credit must either exceed £60,260 (if it is not secured on land) or be secured on land in order for this exemption to apply.

  It should be noted that, in order to be able to rely on this exemption, it must be invoked by the debtor and not by the lender and that the exact requirements of the Exempt Agreements Order 2007 must be complied with. A declaration of high net worth in the prescribed form must be included in the credit agreement and a statement of high net worth in the

prescribed form must be obtained in respect of the debtor. If there is more than one individual debtor under a credit agreement, each of them must qualify in order for the exemption to apply.

- "Business purposes" exemption for agreements above £25,000

  A credit agreement which exceeds £25,000 will not be a regulated agreement if it is entered into by a debtor or hirer wholly or predominantly for the purposes of a business carried on, or to be carried on, by them. If the debtor or hirer makes a declaration to that effect in the form prescribed by the Exempt Agreements Order 2007 in the credit agreement itself, it will be presumed that this is the case.

  Acting in the course of business means in the course of a business regularly carried on by the debtor or hirer. Please note that if the lender or hirer (or anyone acting on their behalf) knows, or has reason to suspect that the agreement is not, in fact, being entered into wholly or predominantly for business purposes, they cannot rely on this exemption.

- Exemption for FSA-regulated mortgages

  "Regulated Mortgage Contracts" (as described in the "Regulated Mortgages" section below) which constitute a regulated activity under the Financial Services and Markets Act 2000 will be exempt from CCA regulation. It should be noted, however, that loans secured by a second (and not first) charge over such property will be regulated by the CCA unless one of the other exemptions applies.

- Exemption for certain agreements secured on land

  In addition to the exemption for FSA-regulated mortgages, certain other types of credit agreements secured on land will be exempt. These can only be relied upon by deposit-takers (i.e. banks or building societies) and certain other bodies (such as local authorities) listed in the CCA and the Exempt Agreements Order 1989.

  The exemptions are for (i) credit agreements secured by a land mortgage where the credit is used to purchase land, a dwelling or business premises; (ii) credit used for land or home improvement where the lender holds a mortgage over the land or property being improved; (iii) credit used to refinance debt which falls within one of the two of the above mentioned categories; and (iv) the "buy-to-let" exemption, which applies to secured loans used to purchase property or land, less than 40% of which is to be used as or in connection with a dwelling by the borrower or the borrower's family.

- Small number of payments exemption

  This exemption will apply if, under a credit agreement for fixed sum credit, the credit is repayable by the debtor in four or fewer payments over a period of less than 12 months and the credit is free of any interest or charges.

- Low cost of credit exemption

  There is also an exemption for certain low interest rate agreements offered to a limited class of individuals, but the technicalities which are to be met before this exemption can be relied on mean that the scope for the application of this exemption is very limited.

What if none of the exemptions apply?

If the credit agreement in question meets the criteria for regulation under the CCA and none of the exemptions apply, the lender must comply with the procedures of the CCA and its Regulations whether it is a licensed consumer credit business or not.

This means that the lender must comply with the pre-contractual requirements of the CCA, the form, content and format of agreements prescribed by the CCA, the post-contractual information provision requirements and the procedures prescribed by the CCA for steps to be taken in the event that things go wrong, and upon enforcement.

Failure to comply with the requirements of the CCA when entering into a credit agreement would render the agreement unenforceable without a court order.

It should be noted that there is a "light touch" regime that would apply to certain types of agreements which are technically covered by and regulated by the CCA, but to which only certain of the provisions of and formalities required by the Act would apply. These include non-commercial agreements, overdrafts and small value agreements.

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Who needs a consumer credit licence?

A lender carrying on a consumer credit business (i.e. "any business being carried on by a person so far as it comprises or relates to the provision of credit by him … under regulated consumer credit agreements") must obtain a consumer credit licence.

The CCA also regulates a number of activities connected with credit agreements, such as credit brokerage, advertising and promoting credit and hire agreements, as well as lending and hiring itself. It also applies to a number of ancillary activities, such as debt adjusting, debt counselling, debt collecting and debt administration, the provision of credit information services, acting as a credit reference agency, credit-brokerage, debt collecting and advertising and can apply even when the agreements being brokered or advertised are not regulated agreements.

It is a criminal offence for an unlicensed person to carry on any activities which require a licence.

"Unfair relationships" and the Consumer Credit Act

It is important for any lender involved in lending to individuals to bear in mind and consider the "unfair relationships" provisions of the CCA, which apply to all agreements entered into with individual debtors. They apply to regulated, exempt and completely unregulated agreements originated after 6 April 2007 and apply retrospectively to agreements entered into prior to that date if they had not been fully completed by that time.

If a borrower alleges that the relationship between the lender and the borrower is unfair to the borrower, it is for the lender to prove to the contrary. If the courts consider that there was an unfair relationship between the borrower and the lender, the provisions of the CCA give the courts the power to "re-open" and vary credit agreements, to discharge any obligation under it, order the repayment of money to the borrower, cancel or return security, reduce or cancel interest or require the lender to do anything else that the court considers necessary.

The term "unfair" itself has not been defined, but, in the assessment of fairness, certain relevant factors will be considered by the courts, including: (i) the way in which the agreement is drafted; (ii) whether the lender engaged in unfair commercial practices, such as making misleading statements; (iii) whether the lender checked the creditworthiness of the borrower or that the financial product in question was suitable in light of the borrower's circumstances; and (iv) the manner in which the creditor has dealt with the borrower, including the manner in which it enforced or sought to enforce its rights.

Regulated mortgages

When is this relevant?

When a lender carries on one or more of the following Financial Services and Markets Act 2000 ("**FSMA**") regulated activities by way of business in the UK:

- advising in connection with,
- arranging,
- administering, or
- entering into as a lender,

  a Regulated Mortgage Contract.

No person may carry on the above regulated activities by way of business in the UK unless he is an authorised person or an exempt person.

What is a "Regulated Mortgage Contract"?

A Regulated Mortgage Contract is one where, at the time it is entered into:

- the lender provides credit to an individual or trustee;
- the lender takes a first legal mortgage over property; and
- at least 40% of the property by area is used or intended to be used in connection with a dwelling by the borrower, or the beneficiary of the trust (where credit is provided to a trustee), or a member of the borrower's or beneficiary's immediate family. In assessing whether the required area is used in connection with a dwelling, reference is made to all associated land area and the aggregate floor areas of each story within a building. Where a single charge is being taken over a portfolio of properties, the assessment is made by reference to the total area of the entire portfolio.

In addition to residential mortgages, "Regulated Mortgage Contracts" can extend to cover a wide range of loans where security is taken over residential property, such as loans for home improvements, lending for debt consolidation, business lending to sole traders

and partnerships in England and Wales, secured overdrafts, secured credit cards and bridging loans.

However, the 40% requirement does mean that the statutory controls will not apply to mortgages secured on most buy-to-let property, timeshare accommodation or mixed use property where the borrower/beneficiary of a trust or his immediate family occupy less than 40% of a dwelling. The statutory controls will also not apply to equitable charges, second mortgages on residential property (although the CCA may still apply), mortgages on commercial property or mortgages granted by limited companies.

What are regulated activities?

If a mortgage comprises a Regulated Mortgage Contract, FSMA will apply to the lender and all intermediaries who are advising, arranging, entering into or administering that Regulated Mortgage Contract by way of business in the UK. When assessing whether a regulated activity is undertaken by way of business, the FSA will consider:

- whether the activity is continuous;
- the existence of any commercial element; and
- the scale of the activity and its proportion to non-regulated activities.

What are the effects of a breach of the Regulated Mortgage Contract provisions of FSMA by a lender?

There are various penalties if an authorised person has not complied with FSMA or an unauthorised person (who is not an "exempt person" for the purposes of FSMA) has been carrying out regulated activities including:

- criminal sanctions (including imprisonment of up to 2 years) and/or a fine;
- any agreement made by a person who has been carrying on a regulated activity without permission will be unenforceable against the borrower;
- private persons (including the borrower) may bring an action for damages for losses arising as a result of a breach by an authorised person of the FSA's Mortgage Conduct of Business rules;
- the FSA investigating and taking enforcement action including by initiating criminal prosecution, levying fines and/or taking disciplinary action against firms and approved persons, including restricting activities or removing their licence to trade;
- the Financial Ombudsman Service taking action to bind the lender/ intermediary following a complaint made by the borrower; or
- compensation may be paid under the Financial Services Compensation Scheme to borrowers if an authorised firm becomes insolvent or ceases to trade after a claim made against it.

Taking security and guarantees from individuals

What issues should a lender consider when taking security from an individual?

Lenders taking security from individuals should consider the following issues:

- CCA security

  Security for credit regulated by the CCA is subject to additional requirements. It must be in writing, adopt the prescribed form, and embody the prescribed contents. If it is provided by the borrower, the terms of the security must be set out in the credit agreement, or a document it refers to. Unless these and numerous other formalities are observed, the security document is not properly executed, and would only be enforceable with a Court order.

  If the credit is not regulated by the CCA (for example because it is provided to a limited company), these requirements do not apply to security provided by an individual in respect of that credit.

- Regulated Mortgage Contracts

  The FSMA legislation and the issues outlined above in relation to Regulated Mortgage Contracts should be considered and, if regulated, the lender will require authorisation from the FSA to engage in any regulated activities in connection with Regulated Mortgage Contracts.

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- Registration

  Subject to what is said below about the Bills of Sale Acts, there is no public registration system for most security given by individuals, although registration may be required in an "asset registry" such as the Land Registry. As a result, such security can be more vulnerable to the legitimate competing interests of third parties.

- Bills of Sale Acts

  A mortgage or charge by an individual or a partnership (other than a limited liability partnership) over "personal chattels" is subject to the Bills of Sale Acts 1878-1882 ("Bills of Sale Acts"). Most goods are personal chattels for these purposes, but the Bills of Sale Acts do not apply to yachts or aircraft and "personal chattels" also exclude shares or interest in the stock, funds or securities of any government, or in the capital or property of incorporated or joint stock companies, and choses in action.

  Unless it falls within one of a number of statutory exemptions (including goods at sea or abroad), the security will be void if it is not in the form required by, and registered under, the Bills of Sale Acts. In practice, these formalities are cumbersome and unattractive to lenders, such that taking a mortgage or charge over personal chattels from an individual is seldom practicable.

  It is sometimes possible to avoid the difficulties caused by the Bills of Sale Acts by taking security over personal chattels in the form of a pledge, rather than a mortgage or charge. A pledge given by an individual falls outside the scope of the Bills of Sale Acts. A pledge gives the lender a proprietary interest in the relevant personal chattels, and confers a power of sale. It should be noted that a pledge requires the delivery of possession of the chattels, or of documents of title to them, to the lender, with the intention of creating a pledge, although the delivery may be symbolic, for example, the borrower may hand over the keys to the warehouse where the chattels are kept.

  There is a degree of "recharacterisation" risk if goods have been purchased in the name of a company, or transferred to a company, in order to enable the company rather than an individual to create security. The purchase or transfer must be a genuine one. The risk is greater where the individual is left in possession of the relevant asset.

- Floating charges

  As shares, cash and purely contractual rights are excluded from the definition of "personal chattels" in the Bills of Sale Acts, it is generally accepted that an individual borrower may give a charge over such assets without concerns arising under the Bills of Sale Acts. However, a floating charge over all of an individual's assets will include "personal chattels" and will fall foul of the Bills of Sale Acts as not being in the form required by, and registered under, the Bills of Sale Acts. That is why, in practice, a floating charge over all assets cannot be taken from an individual. Despite some judicial commentary apparently to the contrary, it is generally thought that an individual may give a floating charge over assets other than personal chattels.

- Financial Collateral Regulations

  Lenders should bear in mind that the Financial Collateral Arrangements (No. 2) Regulations 2003 do not apply unless the collateral provider and the collateral taker are non-natural persons meaning that a right to appropriate financial collateral cannot be included in security given by an individual.

- General assignments of book debts

  If an individual is engaged in business, a "general assignment" of his uncollected book debts by way of security or charge will be void as against a trustee in bankruptcy unless the assignment has been registered under the Bills of Sale Acts. This does not apply to an assignment of book debts due at the date of the assignment from specified debtors or under specified contracts.

- Directors

  There are detailed provisions in the Companies Act 2006 on loans to company directors, and the provision of guarantees or security for a loan made by any person to a director of a company or its holding company. Shareholder approval would be required in these circumstances.

- Undue influence/ duress

  The security granted may be voidable if undue influence or duress is established. The circumstances where this most commonly arises are where a jointly owned matrimonial home is charged to secure the business debts of, or obligations under a guarantee given by, either the husband or wife. Similar issues arise in relation to the waiver or postponement of an occupier's rights. However, the risk arises in relation to all security and not just residential mortgages. The risk of a successful challenge is minimised if the by now well known "Etridge" procedures are followed, by disclosing sufficient details of the transaction to the person providing security (with the borrower's prior approval), requiring them to take independent legal advice, and obtaining written confirmation from the solicitor providing the advice to that effect.

- Misrepresentation

  Like any contract, a mortgage or charge is at risk of being rescinded if there has been misrepresentation. In particular, it may be set aside if it can be shown that a misrepresentation was made by the borrower or that the lender had actual, constructive or implied knowledge of the misrepresentation. Indeed, in many cases where there is undue influence there will also be misrepresentation. The Etridge procedures should again be followed to minimise the risk of a successful challenge of the security.

What issues should a lender consider when taking a guarantee or third party security from an individual?

- Preference

  A guarantee may be challenged on the grounds of being a preferential transaction. Preference arises when a person voluntarily does something at a “relevant time” that favours one of his or her creditors over others, with the intention of doing so, and is bankrupt at the time, or becomes bankrupt as a result. Commercial pressure applied by the lender on the borrower may be sufficient to defeat a preference claim. Simplifying slightly, the “relevant time” is two years prior to the bankruptcy of an individual, except when the transaction is both a preference and at an undervalue, when the period is five years.

- Transactions at an undervalue

  A guarantee given within a “relevant time” may also be challenged on bankruptcy as a transaction at an undervalue: i.e. that the benefit received by the guarantor is significantly less than the benefit conferred on the lender receiving the guarantee. The difficulty of making the comparison between the likelihood that a guarantee will be called and the benefit that the guarantor may derive from giving it means that, in normal circumstances, a claim that giving a guarantee was a transaction at an undervalue is relatively difficult to sustain. Where there is a strong likelihood of default under a facility, the risk is greater. As in the case of preference, the guarantor must be bankrupt at the time, or become so as a result of giving the guarantee. Again simplifying slightly, the “relevant time” is five years prior to the bankruptcy of an individual.

- Undue influence and misrepresentation

  The same concerns arise in respect of undue influence and misrepresentation when taking guarantees, as with taking security from individuals (as outlined above). The prudent course of action for a lender taking a guarantee from an individual is to insist that they take independent legal advice on the guarantee and to follow the Etridge procedures.

Other factors to consider when contracting with individuals

Capacity

A further principle to be borne in mind when dealing with individual borrowers, security providers and guarantors is that a contracting party must have capacity to enter into a contract, although there is no "ultra vires" principle as in the case of a corporation. If a party purports to enter into a contract without capacity, the contract may be voidable under common law because it is beyond the powers of the contracting party. In the case of agreements entered into by individuals, it is presumed that individuals have the capacity to enter into the relevant contractual arrangements, although there are three categories of individuals who may lack personal contractual capacity: minors, people lacking the requisite mental capacity and people who are intoxicated.

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- Minors.

  Anyone below the age of 18 is considered a minor for the purposes of contract law. The general rules are that:

  i. a minor's contracts are voidable at the minor's option;

  ii. a minor can enforce most contracts, but they are not binding on the minor until he or she expressly ratifies them on turning 18;

  iii. a minor cannot acquire or hold a legal estate in land, although a minor may contract to acquire land and the contract will be binding unless and until it is repudiated by the minor; and

  iv. a transfer of a legal estate in land would take effect only in equity and, similarly, a lease granted to a minor would take effect in equity only and would be voidable at the option of a minor; however, if a minor goes into occupation under a lease, he or she will be liable for rent.

A lender dealing with a minor should be aware of the above risks and seek legal advice where relevant.

- People lacking the requisite mental capacity.

  The law requires quite a high level of mental incapacity before it will consider an individual lacked contractual capacity. For example, the following factors would be unlikely to make a contract unenforceable:

  i. The individual not understanding the nature of the transaction. However, in certain cases, undue influence or unconscionable dealing by the other party or potentially, inequality of bargaining power, may permit the transaction to be set aside as being inequitable. For example, in the Barclays Bank plc v Schwartz case, the judge said whilst illiteracy and unfamiliarity with the English language should not be equated with mental incapacity or drunkenness, a person who signed a contract in English without fully understanding it (because their mother tongue is another language) might be able to claim that the contract be set aside as a harsh and unconscionable bargain.

  ii. Immaturity of reason even in an adult.

  iii. Mere absence of skill on the subject of the particular contract.

The law may provide a remedy to the individual in a wide range of circumstances provided that: "one party has been at a serious disadvantage to the other, whether through poverty or ignorance or lack of advice or otherwise so that circumstances existed of which unfair advantage could be taken". Further, if a lender acting in the course of a business takes advantage of the lack of full understanding of the terms of a contract which he or she concludes with a consumer, this may be relevant when considering if the terms are fair or not under the UTCCRs (discussed below).

If an individual is unable to read or understand a document (unless this is due to physical illness or disability, illiteracy or because the document is in a foreign language) the execution clause of a document should be adapted to show how the individual was informed of the contents of the document. In addition, the individual should be asked to obtain independent legal advice and, ideally, a letter from the independent legal adviser to the individual confirming that such advice was given should be obtained by the lender.

A representation could also be included in the relevant agreement that the individual was not of unsound mind or a patient for the purpose of any statute referring to mental health and an additional event of default, enforcement event or termination event could be included in the relevant documents, which would be triggered by reason of illness or incapacity or the individual becoming incapable of managing his or her own affairs or becoming a patient under any mental health legislation. When including such provisions, a lender should bear in mind that there is a risk that such clauses could be interpreted as being discriminatory.

Death

When entering into contractual arrangements with an individual, it is important to bear in mind the risk and possibility of the individual's death. In general, personal representatives step into the shoes of a deceased individual in relation to contracts entered into by that individual and claims made by or against that individual during his or her lifetime, but there are exceptions to the general rule, in particular where the contract provides otherwise or ends on the individual's death.

The fact that the personal representatives of the deceased step into the shoes of the deceased means that: (i) they must meet the liabilities that the deceased incurred before his death out of his estate and (ii) they are entitled to the benefits due to the deceased before his death.

When dealing with an individual, it may be appropriate to include an additional event of default, enforcement or termination to be triggered by the death of the individual. The notices provisions in the relevant agreements could also be amended to provide that, until the lender receives written notice of the grant of probate of the will or letters of administration in respect of the estate of the deceased, and an address for the executors or personal representatives, the lender can use the address provided in the notices section for the purposes of communications under a given document, and that notices delivered to such address will be sufficient.

Bankruptcy and similar proceedings

A lender should seek to include in any loan or security documents a repeating representation from the contracting individual that he or she is not bankrupt, insolvent and has not entered into any voluntary arrangements with his or her creditors.

In addition, a lender should seek to include as an additional event of default, enforcement or termination triggered by the individual becoming or being adjudicated or found to be, bankrupt or insolvent or suspending payment of his debts or being (or being deemed to be) unable to or admitting his inability to pay his debts as they fall due, or entering into a composition or other arrangement for the benefit of his creditors (generally, or with a specific class of creditors), including voluntary arrangements.

Unfair Terms in Consumer Contracts Regulations 1999

When is this relevant?

When dealing with individuals, lenders should bear in mind the implications of the Unfair Terms in Consumer Contracts Regulations 1999 ("**UTCCRs**"), which apply to terms in contracts between a consumer and a provider of services (such as financial services) or a supplier of goods. The UTCCRs allow unfair terms in consumer contracts to be challenged by consumers and a number of statutory bodies which are identified in the regulations. They are in addition to the Unfair Contract Terms Act 1977, which applies to clauses that seek restrict, exclude or avoid liability.

The risk is heightened when a lender is dealing with an individual customer on the basis of standard, non-negotiated terms as the Regulations only apply to agreements which are “not individually negotiated”. If a term is found to fall foul of the UTCCRs, it is void and not binding on the consumer, although the remainder of the agreement will continue to remain in force if it is capable of doing so.

The UTCCRs do not extend to core terms of agreements, such as subject matter and pricing, provided that such terms are expressed in plain and intelligible language, are well presented and have no “hidden” terms.

The UTCCRs impose a test of fairness, which is bound up with the principle of good faith, requiring the lender to act in good faith in its dealings with its individual customers.

What do the Regulations require?

Among other things, the UTCCRs require the lender to:

- **Be transparent.** The UTCCRs require that agreements on standard terms with individual customers be drafted in plain and intelligible language. This means that terms which may otherwise escape the test of fairness (because the terms are core terms or the core bargain) will not do so if they are not expressed in plain and intelligible language.
- **Be fair.** Ensure that terms are fair to a consumer. A contract term that has not been individually negotiated is regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations, to the detriment of the consumer (known as the "fairness test"). If there is doubt about a written term, the meaning that is most beneficial to the consumer will apply, but this benefit of the doubt does not apply in proceedings by a regulator or enforcement body. When examining the fairness of a term, various factors will be taken into account, including the nature of services provided, the circumstances surrounding the conclusion of the agreement at the time it was entered into and any other terms of the contract (apart from the term being examined).

What types of terms could fail the "fairness test"?

Some examples of the types of terms identified in the regulations as terms which may fail the fairness test are terms that, in effect, try to achieve the following:

- Make a customer pay an unfair penalty (e.g. a default interest rate that is seen as a penalty will fall foul of the regulations).
- Mislead a customer about his legal rights, or mislead him about the contract.
- Deny a consumer full redress.
- Tie a customer into a contract unfairly.
- Allow a lender not to perform its obligations.
- Not allow a customer to recover his prepayments on cancellation.
- Allow a lender to vary the terms after the agreement has been agreed.

Care should be taken when incorporating any terms into a lender's standard documents that could be seen to fall within any of the above categories and legal advice sought where there is any uncertainty as to whether a term in a standard form document is fair for the purposes of the UTCCRs.

Lending Code

The Lending Code is a voluntary code of practice which sets out the standards for financial institutions to follow when dealing with consumers. The Code is self-regulatory and covers loans, credit cards, charge cards and current account overdrafts provided to consumers, small charities and micro-enterprises. Compliance with its terms is monitored and enforced by the Lending Standard Board.

When entering into transactions with individuals, a subscribing lender should ensure that it complies with the Code, from the point at which it structures the transaction (for example, the Code states that lenders should not take unlimited guarantees from individuals (other than to support liabilities under a merchant services agreement) for personal and micro-enterprise lending, and the taking of "all monies" guarantees in such cases should be avoided by a subscribing lender.

In addition, when dealing with an individual borrower, guarantor or security provider, a lender should (i) recommend that independent advice be taken by the customer before the agreement is signed and (ii) include a prominent notice in the document stating that the lender has recommended that independent legal advice be taken prior to signing in order to help the individual customer make an informed choice about the agreement and understand the risks and obligations involved, and that the individual is entering into the agreement, having understood such risks, and wishes to be legally bound by it.

The Lending Standards Board expects identified breaches of the Lending Code to be immediately remedied, but it is uncertain whether it confers any legal rights on customers. Lenders should also bear in mind, however, that the FSA's Principles for Business require an authorised firm to pay due regard to the interests of its customers and treat them fairly. Failure to comply with the Lending Code might be taken as evidence that this has not been done.

Foreign law considerations and formalities

When lending to, taking security or a guarantee from an individual resident in a jurisdiction other than England and Wales, a prudent lender would be advised to instruct counsel in the jurisdiction of residence of the individual to ensure that any local law formalities are complied with when entering into or relying on the relevant documentation. For example, in certain jurisdictions, a lender will not be permitted to enforce its rights under its security documents without first obtaining court approval. There may also be registration requirements or requirements to give notice in order to perfect security, depending on the type of asset being charged. Another example is that in certain jurisdictions (such as Russia), spousal consent is required when obtaining a guarantee.

Counsel in the relevant jurisdiction will be able to advise the lender on any such requirements, as well as any other formalities in relation to execution of the guarantee, such as a requirement for notarisation that must be met under the laws of the relevant jurisdiction.

It is also advisable that formal legal opinion be obtained covering the main areas that are likely to be of concern to the lender, in particular, the validity and enforceability of the loan and security documentation under the laws of the relevant jurisdiction.

Diplomatic or sovereign immunity

If the individual is a diplomat or a sovereign, he or she may be able to claim immunity before the foreign courts under local law or before the UK courts under bilateral agreements between the UK and the foreign state. In this situation, a full waiver of immunity will need to be included in the loan and security documents, but the extent to which the foreign courts will give effect to this will need to be checked with local counsel.

Searches and due diligence

- **Bankruptcy and insolvency**. To minimise the risks of dealing with a bankrupt individual, which is outlined above, bankruptcy searches should be carried out against the individual prior to and on the day of completion to ascertain that no bankruptcy petitions have been made against the individual. Bankruptcy searches can be made on the Individual Insolvency Register and at the Land Charges Department of the Land Registry. Consideration should also be given to conducting equivalent searches in other relevant jurisdictions.
- **Companies House**. To ascertain whether the individual has ever been disqualified from acting as a director of a company.
- **Bills of Sale Registry**. To ascertain (in appropriate cases) whether the individual has created security over chattels.
- **Other asset registries**. To ascertain (in appropriate cases) whether the individual has created security over certain classes of asset, such as registered land, and for possible adverse third party rights.
- **Money laundering**. As part of the lender's "know your client" checks and particularly when dealing with a foreign individual that may be a politically exposed person (PEP), care should be taken to ensure that adequate money laundering checks are made and legislation complied with. This becomes even more important when dealing with persons in jurisdictions where money laundering procedures and legislation are not similar to or equivalent to those of the United Kingdom as conducting business with persons in those jurisdictions may necessitate more extensive and thorough checks, which should be conducted at the outset of any transaction.
- **Sanctions**. Searches should be made to ensure that the lender is not contracting with an individual against whom UN, US or EU sanctions are imposed, to ensure that it is not illegal for the lender to enter into the relevant arrangements.

Service of process

When dealing with an individual resident outside of the UK in connection with loan or security documents, the borrower or security provider should be required to appoint and maintain an agent in England and Wales to accept service of process issued in the English courts in any proceedings arising out of the documents or in connection with the transaction. This will prevent the lender from being required to apply to court to serve process outside England and Wales. The process agent appointed should be asked to confirm its appointment directly to the lender.

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