

NEGOTIATING A DEBENTURE FOR A CORPORATE BORROWER: CHECKLIST

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A checklist of key points for a borrower's lawyer to consider when reviewing a debenture prepared by the lender's lawyers.

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CONTENTS

- Scope of this checklist
- Initial checks and practical considerations
- Preliminary documentary considerations
- Covenant to pay
- Nature of different security interests
- Dealing with specific kinds of assets
- Perfection requirements
- Representations
- Undertakings
- Enforcement
- Boilerplate provisions
- Looking forwards

SCOPE OF THIS CHECKLIST

Where a company has to provide security for a loan, a lender will often seek to take that security by way of a debenture. A debenture is a global security document, as it purports to set out the terms on which a company will grant security over all or substantially all of its assets by way of security for a loan (see [Practice note, What is a debenture?: Debenture as a security document](#)). A debenture is, therefore, usually a core component of many security packages.

This checklist provides an overview of the key considerations for a borrower's lawyer to bear in mind when negotiating a debenture for a corporate borrower.

INITIAL CHECKS AND PRACTICAL CONSIDERATIONS

There are certain checks a borrower's lawyers should make before reviewing a debenture to be entered into by the borrower. These include the following:

- Ask the lender's lawyers what asset information they will need to finalise the debenture (for example, details of any real estate interests (both freehold and leasehold), intellectual property rights, shares in subsidiaries, bank accounts and insurance rights) and, if the lender does require any such specific asset information, ask the borrower to provide you with that information. This can help to avoid delays later in the transaction. Asset details will differ depending on the type of borrower and the assets that borrower owns.
- If the borrower holds shares in other English companies, check the articles of association of those companies to see if they contain restrictions that may affect taking security over those shares. For example, they may contain restrictions that make it harder for the lender to sell the shares on enforcement. Restrictions to look for include the following:
 - restrictions that confer discretion on directors to refuse to register a transfer of shares;



- any company lien on any unpaid share capital; and
- any pre-emption rights upon a transfer of shares.

If any such restrictions are included, a lender will typically ask for them to be removed or disapplied to the extent the shares are mortgaged or charged. Avoid delays later in the transaction by taking steps to remove them, or disapply them. For more information on the restrictions to look for and how to deal with them, see [Practice note, Taking security over shares and debt securities: Restrictions in issuing company's articles of association](#).

- Check to see if the borrower has granted security over any of its assets previously. If the borrower is a company or [limited liability partnership](#) (LLP) registered in England and Wales, search for any charges filed against the name of that company or LLP on the Companies House website. If the borrower has created any security interests, consider whether they will be released or will stay in place when the borrower enters into the debenture. If those interests will stay in place, consider whether any priority arrangement should be put in place (see [Practice note: overview, Perfection and priority of security: Subordination and intercreditor arrangements](#)).
- Consider whether the security to be created by the debenture may be vulnerable to challenge under the [Insolvency Act 1986](#). This may be the case if, for example, that security is a [preference](#) or an invalid floating charge. For more information on reviewable transactions, see [Practice note, Reviewable transactions in corporate insolvency](#).
- Consider whether the [financial assistance](#) regime is relevant to the transaction. For example, it may still be relevant where security is granted by a private company to obtain financing for the acquisition of shares in its public parent company. For more information on financial assistance, see [Practice note, Financial assistance](#).

PRELIMINARY DOCUMENTARY CONSIDERATIONS

- Most lenders and law firms have their own standard forms of debenture. Lenders will often present these on a “take it or leave it” basis. The extent to which a borrower will be able to negotiate a debenture will vary. For information on factors that may affect the scope for negotiation, see [Checklist, Negotiating a facility agreement for a corporate borrower: checklist: Scope for negotiation](#).
- Clients (both borrowers and lenders alike) will tend to focus on the loan terms themselves rather than any related security when entering into any debt finance transaction.

To the extent possible, security documentation should be agreed between lawyers, with clients only being involved on commercial points (if any). A client will not necessarily wish to be distracted from the demands of the wider transaction by technical, security-related points which are capable of resolution between lawyers alone.

- Any security document should be carefully tailored to the relevant facility agreement so consider how the debenture will interact in documentation terms with the facility agreement. If certain provisions set out in the facility agreement are intended apply to all “Finance Documents” (or equivalent), then those provisions may not need to be repeated in the debenture. For example, clauses dealing with default interest, fees, costs and other expenses may be deleted from the debenture if the relevant clauses in the facility agreement apply to the debenture. Alternatively, the terms of the relevant clauses in the facility agreement may be incorporated by reference in the debenture. Make sure that terms in the debenture do not conflict with those in the facility agreement.
- On larger deals, a facility agreement may contain a set of common security principles (also known as “agreed security principles”) that are intended to frame the parameters for all security interests regardless of the jurisdictions in which security is granted and the assets over which security is taken. Check to see if the facility agreement contains any such agreed security principles and, if it does, ensure the debenture is consistent with them.
- There may be occasions where either because of the size of the transaction or otherwise, a lender is simply unwilling to negotiate or move away from its standard form debenture. In considering whether to proceed, the borrower’s lawyers should make sure that the borrower is aware of the risks of doing so, bearing in mind the issues referred to in this checklist. In exceptional cases, there may be some residual protection available to the borrower under certain legislation (for example, the [Unfair Contract Terms Act 1977](#) or industry guidelines (for example, under the [Standards of Lending Practice: Business customers](#) (see [Practice note: overview, Taking security: Lending Code and Standards of Lending Practice](#)))).

COVENANT TO PAY

- Most security documents contain a covenant to pay the obligations falling due under the related facility agreement (for example, see [Standard document, Debenture: Clause 2](#)). The covenant to pay is effectively a guarantee to discharge those secured liabilities. It would be rare for the covenant to pay to extend to performance obligations, although this is worth checking and revising where inappropriate. Check

if the covenant to pay is limited to the obligations under the facility agreement alone, or if it extends to all monies owing by the borrower under any account. In the case of the latter, consider whether it is appropriate for the borrower to grant “all monies” security (see [Practice note: overview, Taking security: Secured liabilities - what and whose liabilities can be secured?](#)).

- Consider whether to qualify the covenant to pay so that it only requires payment of the secured liabilities “when they become due” under the terms of the facility agreement. This will avoid any suggestion that a committed facility may become an on demand facility.
- A covenant to pay should not be included in a security document if the security is being granted by a third party security provider, that is, an entity that is not a borrower or guarantor. In such cases, the covenant to pay should be deleted entirely or limited recourse wording included providing that the maximum liability of the security provider is capped at the value of the assets secured.

Practice note: overview, Taking security: Control is crucial). For more information on the different types of security that can be taken, see [Practice note: overview, Taking security: Types of security](#).

- Consider what terminology is used to describe the security. Referring to a mortgage, charge or assignment as being a “first” such security interest is not definitive but it is usual to retain this in the description of the type of security created. Security is usually stated to be granted “with full title guarantee”. The use of these words means that certain covenants under the [Law of Property \(Miscellaneous Provisions\) Act 1994](#) as to, for example, the borrower’s title to the secured assets, will be deemed to be made (see [Practice note, Implied covenants for title](#)). If, as a matter of fact, there are any other permitted security interests outstanding over some of the borrower’s assets, or any priority arrangements in place with third parties, qualifications are occasionally made to the “full title guarantee” covenant to reflect that or, alternatively, any relevant representations and warranties can be amended to reflect the same. For more information on the terminology used to describe security, see [Standard document, Debenture: Drafting note, Grant of security](#).

NATURE OF DIFFERENT SECURITY INTERESTS

- A debenture will usually include the following types of security interest:
 - a [mortgage](#) over real property;
 - [fixed charges](#) or assignments over various other assets depending on the assets in question and what type of security interest is most appropriate for those assets; and
 - a [floating charge](#) over the whole of the borrower’s undertaking and all of its present and future assets, other than those subject to any fixed security.

Consider which of the borrower’s assets should be subject to fixed security and which should be subject to floating security, bearing in mind the nature of the transaction and the borrower’s business. Fixed security over certain assets may be entirely inappropriate (for example, if the borrower needs to deal with those assets in the ordinary course of its business). Remember that simply describing a charge as fixed will not necessarily prove conclusive if in fact the lender lacks sufficient control over the relevant assets in question (see

DEALING WITH SPECIFIC KINDS OF ASSETS

- Check which assets are to be subject to fixed security. Assets subject to fixed security should preferably be limited to material assets only, as otherwise there is a risk that the time and costs (which will be paid by the borrower) associated with conferring fixed security for the benefit of the lender outweigh the benefits associated with having such security. Assets that the borrower expects to be able to deal with in the ordinary course of its business, such as stock in trade and monies standing to the credit of its current bank accounts, should be subject to the floating charge only.
- Check whether the debenture contemplates a fixed charge over the borrower’s book debts and take instructions from the borrower as to whether it is willing to give a fixed charge over its book debts. A borrower will typically not want to give a fixed charge over its [book debts](#) because the proceeds from them often represent its main source of cashflow. The control a lender will need to exercise over the borrower’s book debts in order to create a fixed charge over them is likely to mean that the borrower is unable to run its business as it wishes.

For more information on charges over book debts, see [Practice note, Taking security over choses in action: Taking security over book debts](#).

- If the debenture includes charges or assignments of rights under contracts, check whether any of the borrower's contracts (for example, leases) contain restrictions on the borrower charging or assigning its interest. If they do, it may be necessary to ask the lender to carve those contracts out of the security package. For information on the issues raised by restrictions and prohibitions on assignment, see [Standard document, Security assignment of contractual rights: Drafting note, Restrictions and prohibitions on assignment](#).

However, a lender will usually resist excluding such contracts from the security altogether, as this may result in the debenture failing to meet the threshold of a [qualifying floating charge](#) and so prevent the lender from appointing an [administrator](#) out of court on enforcement. In practice, in the case of any income-producing contract, what the lender is really looking for is for the security to attach to the proceeds payable under that contract rather than any ability to step in as assignee on enforcement. As such, a lender will often accept a charge over the receivables arising under such a contract alone, and will forego any requirement for a specific assignment by way of security of the contract itself. Another alternative that a lender might agree to is for any contracts containing restrictions on the borrower charging or assigning its interest to be excluded from the scope of any fixed charge or assignment pending any third party consent to charging or assigning being obtained. Such a contract would be caught by the floating charge alone in the meantime. For an example of a clause excluding certain contracts from security being created, see [Standard document, Debenture: Clause 3.6](#).

- Check the details of any insurance policies that are to be subject to security. Be careful with insurance policies that provide for any claim proceeds to be paid to a third party. These policy rights are not strictly speaking capable of assignment in favour of a lender and should therefore be excluded from the scope of security. For more information on taking security over insurance policies, see [Standard document, Security assignment of contractual rights: Drafting note, Insurance policies](#).
- Check whether any of the borrower's bank accounts are to be subject to a fixed charge. A

bank account subject to a properly created fixed charge is effectively a blocked account as the lender will control withdrawals from that account. This may be inappropriate if the borrower expects to access funds in that account in the ordinary course of its business. However, a fixed charge over certain types of bank account (for example, a prepayment account) may be acceptable to a borrower. For more information on security over bank accounts, see [Practice note, Taking security over cash deposits](#).

- If the debenture includes a floating charge (which it invariably will do), check the circumstances in which it crystallises into a fixed charge. Ideally automatic crystallisation events should be removed so that crystallisation only occurs upon notice by the lender after the occurrence of certain events (such as an event of default that is continuing or where the floating charge assets are, in the reasonable opinion of the lender, in danger of being seized or are otherwise in jeopardy). The lender should not have discretion to convert the floating into a fixed charge merely because it considers it desirable to do so.

Consider whether to require the lender to give notice when any event that prompted crystallisation of the floating charge into a fixed charge ceases to apply so that the borrower can again deal with the relevant assets in the ordinary course. For more information on crystallising floating charges, see [Practice note: overview, Taking security: Crystallisation of floating charges](#).

PERFECTION REQUIREMENTS

- Check what steps the debenture requires the borrower to take to perfect the security interests created. Perfection requirements in a debenture will typically require the following steps to be taken:
 - registrations to be made with public registries (for example, HM Land Registry, Companies House or the Intellectual Property Office);
 - notices to be served on third parties (for example, account banks or material contract counter-parties); and
 - original documents of title to be handed over to the lender (for example, original share certificates and signed but undated stock transfer forms).

A borrower may not be willing (or able) to deliver all title documents to the lender, so consider qualifying any obligation to deliver title documents to those that are expressly requested by the lender.

- Check the timing for attending to any perfection requirements and consider whether any deadlines are acceptable. For example, where the loan is intended to finance the acquisition of shares in target companies and shares in those companies are caught by the debenture, consider whether any time extension is needed to complete any stamping exercise with HM Revenue & Customs before share certificates can be issued to the transferee and delivered to the lender.

Obligations to complete registrations with HM Land Registry or Companies House “immediately” or “promptly” should preferably be watered down or aligned to the relevant priority search period (in the case of land registration) or registration period prescribed by statute (in the case of registration at Companies House). For information on registering security interests generally, see [Practice note: overview, Perfection and priority of security: Registration](#).

- Check what the requirements are (if any) in the debenture for obtaining acknowledgements from third parties to any notices of security. Some debentures require notices to account banks, landlords or insurers, for example, to be acknowledged by the addressees within a prescribed period and for the borrower to use “best endeavours” to obtain such acknowledgements. For perfection purposes the giving of the notice is the important thing (see [Practice note, Taking security over choses in action: Notice](#)), not whether the relevant addressee acknowledges that notice. As such, ask for any such “best endeavours” or, worse still, any absolute obligations on the borrower to procure acknowledgements from third party addressees of any notices of security to be deleted and replaced with a “reasonable endeavours” obligation only. In most cases, a borrower will be unable to procure that third parties over which it has no control provide such acknowledgements. For more information on notices of security and acknowledgements, see [Standard document, Debenture: Drafting note, Notices to be given by the Borrower](#).
- Where time and costs allow, try to agree the form of notices of security and the related acknowledgements with any relevant third parties

before the debenture is executed in order to avoid any complications later.

Some notices and forms of acknowledgements may contain provisions (such as step-in rights or undertakings from the third party addressee in favour of the lender) that go beyond what is absolutely required in order to create legally enforceable security and that may be unacceptable to the relevant third parties. Banks, for example, are unlikely to accept an acknowledgement that requires them to waive their set-off rights or rights of consolidation in respect of an account held with them.

A borrower may not be willing to give notices of security in certain circumstances. In those cases where it is commercially unacceptable to give notices, consider providing pre-signed but undated notices to the lender when the debenture is signed so that the lender can date and serve them on the relevant third parties following a default only.

- Some debentures require the lender’s interest in any insurance policies to be noted on the relevant policies, or alternatively for the lender to be named as first loss payee or co-insured in respect of those policies (see [Practice note, Insurance contract law: general principles: Noting, joint and composite insurance](#)). Ask the borrower to check with its insurance broker whether these options are in fact possible and what the cost and practical implications of each are. Where either is impractical, revise the debenture accordingly.
- If the debenture is intended to be a second-ranking debenture, be careful with any perfection obligations that require the borrower to give documents of title to the second-ranking lender. The borrower will typically have given those documents to the first-ranking lender already, so will not be able to give them to the second-ranking lender. Address this issue by providing in the second-ranking debenture that delivery of such documents to the first-ranking lender constitutes delivery of them to the second-ranking lender.

REPRESENTATIONS

Any representations to be given by the borrower should be limited to the nature of the security being granted and the secured assets only. They should be consistent with any equivalent representations in the facility agreement, both in terms of scope as well as the times at which they are given.

So if, for example, the representations in the facility agreement have been qualified by reference to materiality, awareness or some other threshold, make sure any equivalent representations in the debenture are qualified in the same way. In addition, check that all representations are factually correct and if they are not, amend them accordingly.

UNDERTAKINGS

- Ideally, from a borrower's perspective, the undertakings should be limited to a *negative pledge* and disposals restriction only, since these are essential in terms of protecting the lender's interests and the negative pledge will be reflected on the borrower's charges register when the debenture is registered with Companies House. However, lenders will often require further undertakings that go beyond the secured assets in question (for example, restrictions on amending contracts, altering any property situated on any real estate, compliance with all environmental and planning laws, waiving or amending any terms applicable to the payment of any debts owing to the borrower and withdrawing sums from bank accounts) on the basis that a debenture usually extends to both present and future assets. There will always be a balance to be achieved between protecting the lender's interests and ensuring the debenture does not prove unmanageable from the perspective of the borrower's business.
- Consider whether the undertakings are appropriate to the relevant transaction. For example, if real estate is not material to the borrower's business, consider whether an extensive list of property undertakings is really appropriate.
- As with the representations, qualify any undertakings where appropriate by reference to materiality or some other threshold. For example, in the case of restrictions limiting amendments to material agreements, request a carve-out for non-material amendments that should not require the lender's consent. Similarly, covenants requiring compliance with all laws and regulations can be watered down so as not to bite on minor breaches or those that are remedied within an agreed grace period.
- The facility agreement may provide that certain kinds of "permitted" transactions can take place without the borrower having to seek lender consent and without triggering any default. Make sure the

debenture takes account of these "permitted" transactions, so that, for example, the negative pledge does not restrict any "permitted security" from existing or being taken, and the disposals restriction allows for any "permitted disposal".

- A debenture will often include specific undertakings dealing with the exercise by the borrower and the lender of their respective rights in relation to specific assets. This is typically the case with assets such as bank accounts and any shares in, or receipts of dividends from, the borrower's subsidiaries. A borrower and a lender will have differing views on the level of control a lender should be able to exercise over such rights so check whether any such undertakings are acceptable to the borrower and if they are not, amend them accordingly.

A good compromise is for the borrower and lender to agree a different treatment of those rights before and after default or enforcement. So, for example, before an event of default or enforcement under the debenture, the lender may allow the borrower to access its funds in its bank accounts (other than any account subject to a fixed charge), as well as to receive dividends and other distributions from its subsidiaries and exercise any voting rights in relation to the shares it holds in those subsidiaries. After an event of default or enforcement under the debenture, a lender will typically block the borrower's access to its bank accounts and provide that all dividends and distributions should be paid to the lender and that the lender may exercise the voting rights in relation to the borrower's shares in its subsidiaries.

For an example of provisions governing voting rights and dividends, see *Standard document, Charge over shares: Clause 7*.

- Check for and ask the lender to delete any unusual or particularly onerous undertakings. These might include, for example, an agreement to pay the costs of any reporting accountants engaged by the lender or a requirement to update the list of fixed charge assets at regular intervals.
- Check whether there are provisions in the debenture that contradict what is required under the facility agreement (for example, provisions dealing with the application of insurance proceeds that contradict any related mandatory prepayment provision in the facility agreement) and address any inconsistencies.

One way of addressing any inconsistency between the undertakings in the facility agreement and those in the debenture is to include an “override” provision. This language provides that, if the terms of the facility agreement and the debenture are inconsistent, the terms of the facility agreement take precedence over the terms of the debenture. Sometimes a lender will propose “override” language where the debenture is in standard form and the lender is not willing to amend it. When acting for a borrower, however, be wary of any such wording, as it may not necessarily solve the borrower’s problems. For example, if a covenant is qualified by materiality and/or reasonableness in the facility agreement, but there is an equivalent covenant in the debenture that is unqualified, the override language will not necessarily import qualifications into the covenant in the debenture because the covenants in the facility agreement and debenture, though different, are not necessarily inconsistent or in conflict with each other.

covenants, consider limiting such rights so that they are only exercisable after the security becomes enforceable.

BOILERPLATE PROVISIONS

- Make sure there is an obligation in the debenture for the lender to release the security created by the debenture, either in full upon the discharge of the secured obligations or in part in connection with any permitted disposal of specific assets. This is particularly important in a syndicated transaction, as it may avoid any delay associated with a security agent seeking instructions from the lenders before releasing the security.

For an example of a release provision in a debenture, see *Standard document, Debenture: Clause 23*.

- It is common for debentures to include a power of attorney enabling the lender to take any step or execute any document that, for example, is necessary to perfect the security or facilitate the realisation of any secured asset on enforcement. It is usual to try and limit the circumstances in which any such power can be invoked, to either following default or enforcement, or to whenever the borrower has failed to comply with a further assurance obligation after being asked to do so.

For more information on a power of attorney in a debenture, see *Standard document, Debenture: Drafting note, Power of attorney*, and for more information on further assurance provisions, see *Standard document, Debenture: Drafting note, Further assurance*.

- A debenture will usually include a provision dealing with the application of recoveries realised upon enforcement (for example, see *Standard document, Debenture: Clause 19*). Make sure the terms of this provision are consistent with the application of recoveries provisions in the facility agreement or intercreditor agreement (if any).
- Limit set-off provisions so that they are only exercisable in respect of matured amounts that have fallen due for payment (not before). For information on set-off clauses, see *Practice note, Set-off clauses*.
- Ensure that any rights for the lender to retain any realisations from enforcement in a suspense

ENFORCEMENT

- A lender’s right to enforce its security under a debenture needs to be tied to the related facility agreement. So, for example, enforcement of the security should only be possible after the occurrence of an event of default that is continuing under the facility agreement (for example, see *Standard document, Debenture: Clause 14*) or, better still, that has resulted in the lender exercising any of its rights to accelerate the loan(s) under the facility agreement (a so-called “declared default”). Avoid a situation where the debenture is enforceable before any right to accelerate under the facility agreement has arisen.
- A lender’s remedies and powers upon enforcement are rarely negotiated in practice. Where the debenture is not a qualifying floating charge, consider limiting the lender’s enforcement powers to the secured assets only (removing any wider powers to, for example, manage the business of the borrower generally). For more information on qualifying floating charges, see *Practice note: overview, Administration: Routes into administration*.
- Some rights granted to a lender in a debenture are by their very nature more appropriate in an enforcement context. An example of such a right might include a right that enables the lender to access the borrower’s premises to inspect the secured assets. If the debenture contains any such

account only apply up until (but not after) the amounts recovered are sufficient to discharge the secured obligations in full and the lender has no obligation to advance further monies.

- A debenture will often provide for the security to be retained after discharge of the secured obligations or reinstated following release where any payment is avoided (so-called “discharge conditional” provisions). For an example of such a provision, see [Standard document, Debenture: Clause 30.3](#). These provisions can be hard to resist and lenders usually prefer to retain them as a fall-back option even though they are rarely used in practice. A strong borrower may be able to persuade a lender to forego such rights, as upon repayment the borrower (and any refinancing lender) will want an absolute and unconditional discharge of security and lenders can always seek to avail themselves of those protections under the [Insolvency Act 1986](#) that confer sweeping powers on the courts to make “such orders as [they] see fit” to do equity between the parties.

At the very least, make sure that any entitlement to retain security does not extend beyond the period during which transactions can be challenged under the relevant legislation. For more information on the types of transactions that may be challenged, see [Practice note, Reviewable transactions in corporate insolvency](#).

- Provisions dealing with fees, costs and expenses and any indemnities, can usually be deleted to the extent adequately dealt with in the facility agreement. Where this is not the case, review such clauses carefully as they can often be very broadly drafted.

It is common for fees to extend to legal fees but be sure to limit these where appropriate so that they are subject to any caps previously agreed between the borrower and the lender.

A distinction is often made in respect of those fees incurred before and after enforcement, so that any obligation on the borrower to cover any fees incurred by the lender before enforcement only extends to those fees that are reasonably incurred. Check that this is the case in the debenture.

Check to see if the debenture entitles the lender to recover additional fees associated with its management time, for example, when

administering or enforcing the security. This may not be appropriate.

Finally, indemnities can be broadly drafted so try to limit these where possible. For example, an indemnity should not extend to any liabilities incurred by the lender by reason of its own gross negligence or wilful default.

- A lender will want a right to assign or transfer the benefit of the debenture. This is acceptable, but make sure that it is limited so that it is in accordance with the related facility agreement or intercreditor agreement (if any). To the extent the lender is able to disclose information about the borrower and its assets (whether in connection with any such assignment or transfer or otherwise), make sure this right is consistent with any confidentiality provisions in the facility agreement.

LOOKING FORWARDS

- Make sure the debenture is registered at Companies House where required. The lender’s lawyers will usually register the security, but given the consequences of non-registration (for example, the secured debt becomes immediately due and payable), the borrower’s lawyers should always ensure the registration is in fact made. For more information on the consequences of non-registration, see [Practice note: overview, Registration of charges created by companies and limited liability partnerships on or after 6 April 2013: What is the effect of failure to deliver a section 859D statement of particulars before the end of the period allowed for delivery?](#)

[Financial collateral arrangements](#) do not need to be registered with Companies House, but this exception is unlikely to be of much relevance in the context of a debenture where the secured assets go beyond what constitutes “financial collateral” within the meaning of the [Financial Collateral Arrangements \(No.2\) Regulations 2003 \(SI 2003/3226\)](#). For more information on financial collateral arrangements, see [Practice note, Financial collateral arrangements](#).

- If the debenture requires the borrower to serve notices of security on third parties where future assets are acquired, make sure the borrower is aware of these requirements and what it needs to do to ensure compliance.