

Granting, perfection and enforcement of security over shares in British Virgin Islands

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Security over the shares in a British Virgin Islands (BVI) company may be granted either by way of a mortgage or charge pursuant to the provisions of the BVI Business Companies Act (the “Act”). The purpose of this briefing is to describe the types of security which can be taken over shares in BVI companies and various issues in relation to the granting, perfection and enforcement of such security.

Under BVI law, the register of members of a BVI company provides prima facie evidence of the legal ownership of the shares in the company. No transfer of shares (by way of security or otherwise) is effective until the register of members is updated. The register of members of a BVI company is typically (although it need not be) held by the registered agent of the company. The registered agent will need to be instructed to make the necessary amendment to the original register of members of the BVI company.

Security

A shareholder may grant security over shares in a BVI company either by way of a legal mortgage, or by way of an equitable mortgage or charge. Such a mortgage or charge over shares need not be in any specific form, but must clearly indicate: the intention to create a mortgage or charge; and the amount secured by the mortgage or charge or how that amount is to be calculated. There is no requirement for the mortgage or charge to be governed by BVI law. It must create valid security under its stated governing law.

It is not possible to ‘pledge’ registered shares under BVI law, given that ownership of registered shares in BVI companies is not transferred by way of physical delivery.

In addition to a mortgage or charge over the shares, the company itself may possess a lien over the shares (usually pursuant to its articles of association), as security for amounts owed to the company by the member. The shares may be forfeited to the company upon default.

Legal mortgage

Grant of legal mortgage

A legal mortgage is created by the execution of a mortgage agreement between the mortgagor and the secured party and the transfer of legal title (depending on the terms of the mortgage agreement) in the shares to the secured party. Once the mortgagor has repaid the underlying debt, or the secured obligations have been discharged, the mortgagee is required and duty bound to transfer the shares back to the mortgagor.

Registration and priority

Where the mortgagor is a BVI company, the registration procedures under sections 162 and 163 of the Act apply. Priority of the mortgage will depend upon the date of public registration of the mortgage in accordance with section 163 of the Act.

For further information in this regard please see the Carey Olsen Legal Guide [Registering Security in the BVI](#).

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Where the mortgagor of shares in a BVI company is not itself a BVI company, it should be ensured that any registration requirements in the jurisdiction of incorporation of the mortgagor are complied with. In either case the perfection requirements listed below in respect of the BVI company whose shares are secured should also be addressed. The priority of the mortgage will be governed by the law of the jurisdiction of incorporation of the mortgagor and/or the foreign law governing the mortgage agreement.

Section 163 of the Act provides for the creation of a public register of charges for a BVI Company by filing an application to register a charge with the BVI Registrar of Corporate Affairs (the "Registrar"). It is not mandatory to file such an application and failure to do so will not affect the validity of the security created by the mortgage, however it is the public register of charges of the BVI mortgagor which determines priority of security under BVI law. Mortgages which are registered in accordance with section 163 of the Act take priority over those which are not registered. Mortgages which are so registered also have priority over mortgages which are subsequently registered (subject to any intercreditor arrangements which have been entered into) other than registered floating charges which will rank behind a subsequently registered fixed charges (unless the floating charge contains a prohibition or restriction on the power of the company to create any future charge ranking in priority to or equally with the charge). There is no deadline for updating the public register under section 163 of the Act. However, as priority of the security is determined based on the date and time of the public filing with the Registrar, this filing should be completed immediately to minimise the risk of a subsequent competing charge taking priority.

Please note that a different priorities regime applies in respect of BVI companies incorporated under the International Business Companies Act ("IBC Companies"). Please contact us for further information should your transaction involve security granted by, or over the assets of, an IBC Company.

Perfection

Prima facie ownership of registered shares in a BVI company is determined by the register of members. A legal mortgage is perfected by a transfer of the shares into the name of the secured party/mortgagee. The transfer occurs when the company's register of members is amended. The company's articles of association will often give its directors discretion in relation to the registration of transfer. The secured party should therefore require either: (i) removal of the discretion by way of an amendment to the articles of association; or (ii) evidence of the approval of the transfer (e.g. a signed board resolution), before entering into the transaction being secured.

Where the BVI company has previously elected to publicly file its register of members with the Registrar, it is bound by the contents of this public register of members. The Registrar must be notified of any changes to the register of members (e.g. any transfers of the shares) and each time a change is made the company must file an updated register of members with the Registrar. A transfer of the shares will only be effective once this filing has been made. This obligation continues until the company files a notice confirming that it will no longer maintain a public register of members (which usually requires the secured party's consent). Once this notice has been filed, the BVI company will not have to notify or provide the Registrar with an updated register of members – it is only required to maintain and update its private register of members.

Enforcement

The Act provides that, where the governing law of the mortgage is the law of the BVI, the remedies set out in section 66(5) of the Act (the power of sale and the power to appoint a receiver) may not be exercised until an event of default has occurred and is continuing for a period of not less than thirty days (or such shorter period as specified in the mortgage) and which has not been rectified within 14 days (or such shorter period as specified in the mortgage). Section 66(7A) of the Act provides that, where the governing law of the mortgage is that of the BVI, and if the instrument creating the mortgage or charge specifically provides, the remedies referred to in section 66(5) of the Act will be exercisable immediately upon a default occurring. Where the governing law of the mortgage is not that of the BVI, legal advice should be obtained in respect of the enforcement rights available under the governing law of the mortgage.

The rights on enforcement available in the BVI include:

- **Power of sale:** The secured party has the right to sell the mortgaged shares as and when it chooses, subject to an obligation to the mortgagor to act in good faith and to obtain the best price reasonably obtainable on the day it exercises its power of sale. The secured party must not merely aim to recover the amount of the debt due. Any surplus proceeds must be remitted to the mortgagor. In the event of a breach of the duty of good faith, the mortgagor can apply to the court to prevent or reverse the sale.
- **Retention:** In rare cases, the secured party may have valid reasons to retain control of the shares itself, rather than simply sell the shares, or appoint a receiver. BVI law does not prohibit such retention of the shares, though the secured party must be aware that the shares will be subject to redemption by the mortgagor upon the settlement of the debt.

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- **Appointment of a receiver:** The Act provides that a secured party has the right to appoint a receiver who may vote the shares, receive dividends and exercise other rights attaching to the shares. The receiver will usually effect the secured party's sale of the mortgage shares.
- **Foreclosure:** On a default the secured party may apply to the Court for a foreclosure order, which will result in the secured party becoming the absolute owner of the shares (i.e. no longer subject to any rights of the mortgagor). A foreclosure order will usually only be granted after the Court has first ordered a sale of the shares which has proved unsuccessful.

Advantages/disadvantages

Any legal owner of shares in a BVI company is generally treated as the absolute owner of those shares. This includes a secured party pursuant to a legal mortgage, as legal title passes to the secured party at the outset. The following issues must be considered:

- As legal owner, the secured party will receive all dividends on the shares and will be entitled to exercise any voting rights attaching to those shares. These rights can be effectively given back to the mortgagor through the grant of a power of attorney or a proxy, but such measures will be revocable at any time by the secured party.
- As legal owner, the secured party will also be subject to the obligations of a registered shareholder. It should ensure that the shares are fully paid and non-assessable and that it is granted an indemnity from the mortgagor in the mortgage agreement.
- Depending on the level of ownership represented by the shares, the secured party may find that it is required by the accounting rules of its own jurisdiction to produce consolidated accounts, which include those of the company.

Equitable mortgage or charge

Grant

More often than not, given the various disadvantages in respect of legal mortgages raised above, an equitable mortgage over shares is preferred over a legal mortgage. An equitable mortgage is treated as an agreement to create a legal mortgage. An equitable charge differs from a legal mortgage by virtue of the fact that it does not constitute an agreement to transfer legal title to the shares. However, the steps that must be taken to evidence such a charge will be materially the same as those required to evidence an equitable mortgage, so there is usually no practical distinction.

An equitable mortgage can be created by:

- an agreement to create a legal mortgage; or

- a transfer of shares which is not perfected by entering the secured party in the company's register of members as holder of the shares (this may occur accidentally or where the executed (but undated) instrument of transfer and share certificate (if any) are delivered to the secured party by way of security); or
- a deposit of the relevant share certificate(s) (if any), by way of security.

Priority

Please see above in relation to the priority rules in the BVI where the chargor is a BVI company. A third party (bona fide) purchaser for value of the shares, who does not have notice of the equitable mortgage, can take a transfer of those shares free of that security.

Although not strictly a form of security registration, where security has been granted over shares of a BVI company, a secured party should require the BVI company to make an annotation on its register of members confirming: that the shares are charged; the name of the chargee; and the date on which the statement and name were entered in the register of members. The making of such an annotation on the register of members is not mandatory and does not have any specific statutory effect, other than giving actual notice of the security interest to any person who views the register of members. There is a strong argument that such an annotation provides constructive notice of the security interest to any person dealing with the shares.

It is common for a secured party to demand that the annotated register of members be filed with the Registrar. The effect of this is to make the register of members available for public inspection and therefore increase the range of persons with actual notice of the security interest (please see above in this regard).

Perfection

An equitable mortgage cannot be perfected in the same manner as a legal mortgage, however certain methods are available to improve the quality of the security. These include:

- **Mortgage agreement:** The secured party should ensure that there is an agreement evidencing the equitable mortgage and setting out its terms. These will be substantially similar to those set out in a legal mortgage, save that legal title to the shares is not transferred.
- **Deliverables:** The secured party should ensure that it receives, from the mortgagor, the following items:
 - all original share certificates (if any) in respect of the shares
 - signed and undated instruments of transfer in respect of the shares

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- a signed and undated letter of resignation from each director of the company
 - a certified true copy of the company's register of members, annotated to include details of the equitable mortgage, and evidence of the filing of that register with the Registrar
 - an irrevocable undertaking from the company's BVI registered agent to act on instructions from the secured party in respect of the company
 - a letter of undertaking from each director not to register any transfer of shares whilst the equitable mortgage is in existence
 - confirmation from the directors of the company that the shares have been validly issued, are fully paid up and that no lien exists so that the directors will be estopped from denying the same in the future; and
 - confirmation from the company's BVI registered agent that the share register will be updated immediately upon receipt of a signed and dated instrument of transfer.
- **Power of attorney:** The mortgagor should grant a power of attorney to the secured party enabling it to execute a transfer of the shares into its name and any other related documentation, upon a default. This can be set out in the mortgage agreement, or as a separate power of attorney, but in either case it must be executed as a deed to be effective. As a power of attorney granted by way of security, the power will be irrevocable. However, registration of the transfer would still be subject to any discretion of the company's directors (see below).
 - **Memorandum and articles of association:** If the mortgaged shares carry sufficient voting rights to pass a resolution of the company, the mortgagor should be required to amend the company's articles of association to make enforcement of the security easier. Such amendments would normally include the removal of any discretion of directors to refuse to register transfers, an obligation on the company to take notice of security interests in the shares, removal of any right of the company to take a lien over issued but unpaid shares and removal of any right of compulsory redemption by the company.
 - **Notice to the company:** It may be in the secured party's interest to put the company on notice that it has taken security over shares in the company. Notice to the company may give the secured party's security interest priority over the company's lien over the shares in respect of any subsequent advances made by the company to the mortgagor. It is possible to make the company itself party to the equitable mortgage, in which case the company can be asked to expressly waive such lien and its rights of forfeiture in respect of the shares.

Enforcement

- **Timing:** The considerations as to timing referred to above in respect of a legal mortgage apply equally to an equitable mortgage.
- **Transfer:** If the secured party has been granted a power of attorney and/or delivered an executed share transfer in respect of the secured shares, on a default it will be able to deliver the executed transfer to the company and, subject to any discretion of the directors to refuse to register transfers, it will be registered as the legal owner of the shares. At this point it will be in the position of a legal mortgagee and may take the enforcement steps set out above.
- **Power of sale:** Following the transfer of the shares to the secured party, the secured party may sell the shares as discussed above.
- **Retention:** As with a legal mortgage, the secured party may decide to retain the shares in its own name on enforcement. In the case of an equitable mortgage this will mean effecting the steps required for transfer as discussed above. The considerations discussed above for legal mortgages apply equally to retention pursuant to an equitable mortgage.
- **Appointment of receiver:** As with a legal mortgage, the secured party under an equitable mortgage has the power to appoint a receiver as discussed in above.
- **Foreclosure:** As with a legal mortgage, on a default the secured party may apply to the court for a foreclosure order as discussed above.

Conclusion

This legal guide deals specifically with security taken over shares in BVI companies as a matter of BVI law alone. The Act does permit security over shares to be governed by the laws of a foreign jurisdiction provided that the instrument creating the security complies with the laws of that foreign jurisdiction. The remedies available to a mortgagee or chargee will be subject to the governing law and the instrument creating the security. For example, where the governing law of the security document is that of England and Wales the concept of Appropriation (as defined under English law) will in theory be available as an enforcement remedy in favour of the chargee.

The rights between the mortgagor or mortgagee as a member of the company and the company continue to be governed by the memorandum and articles of the company and the Act.

This is a summary of the issues relevant to the subject. It is not intended to be a substitute for specific legal advice. In many cases issues of foreign law as to perfection and priority may also be relevant. These issues are beyond the scope of this summary.

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