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## *The Effects of a Mandatory Register of Beneficial Ownership*

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*Some of the many attractions of the British Virgin Islands (the **BVI**) for both corporates and lenders are the relatively sophisticated legal system, low operating costs and creditor friendly insolvency regime. In recent times the BVI, along with other offshore jurisdictions, has come under criticism for lack of transparency of ownership of companies. At June 2013's G8 summit, the United Kingdom government announced plans for the United Kingdom and its overseas territories and crown dependencies to establish mandatory registers of beneficial ownership. It has since been indicated that such registers will be publicly available. In response the BVI government issued a consultation paper on the subject in October 2013, with a consultation period running until the end of January 2014.*

Whilst it is unclear if a publicly available register of beneficial ownership will be introduced in the BVI, if a mandatory register of beneficial ownership (either privately or publicly available) was established, it is worth considering what would be the impact on taking security over shares issued by a BVI company which are owned by separate legal and beneficial owners? Billions of dollars of debt finance have been advanced upon the strength of such security and remain outstanding. (For the purposes of this article, only registered shares issued by companies registered under the BVI Business Companies Act 2004 (the **BVBCA**) are considered).

### **Financing involving BVI companies**

One of the more common debt financing structures in the BVI involves a BVI company as an asset holding vehicle: either assets located outside the BVI or shares in its foreign subsidiary (which directly owns the foreign assets being financed). In addition to the non-BVI asset level security, and, where applicable, share security over the foreign subsidiary, the lenders

will take security over the shares in the BVI holding company, thus simplifying enforcement and allowing them to exert control over the entire company group. Where the underlying assets or shares held by the BVI company are illiquid or may be difficult to enforce for legal, commercial or regulatory reasons, the security over the BVI shares becomes in effect the primary security.

BVI statute has been designed to facilitate and simplify the process of granting security over the shares in BVI companies and security granted by BVI companies. The BVIBCA allows shares in a BVI company to be secured by a foreign law security document and for the application of remedies available under that foreign law. An example of the application of a foreign law remedy is the English remedy of appropriation, which was considered at great length in the long running *Alfa Telecom v Cukurova Finance* litigation.

Under section 42 of the BVIBCA, the “entry of the name of a person in the register of members as holder of a share in a company is prima facie evidence that the legal title in the share vests in that person” and a BVI company “may treat the holder of a registered share as the only person entitled to (a) exercise any voting rights attaching to the share, (b) receive notices, (c) receive a distribution in respect of the share and (d) exercise other rights and powers attaching to the share.” These powers include granting security over those shares.

### **Legal and beneficial ownership in the BVI**

Thus far everything seems straightforward, however the BVI, like most common law jurisdictions, has well-established trust laws which are derived from the principles of English common law and equity; this allows separate legal (the technical title to) and beneficial (the economic interest) ownership in shares issued by a BVI company. If the secured party was only to take security over the bare legal title to the shares, so effectively stepping into the shoes of the chargor without getting the benefit of the beneficial ownership, then there would be no real economic value to that share security.

When taking share security the secured party should inspect the share register of the charged company, a document which is not usually publicly available but is available from the company’s BVI registered agent. The share register would usually list the details of the legal owner of the shares and would not include any evidence of a separate beneficial owner; assuming that the legal owner is not a trust or nominee company, which, it could be argued, ought to alert the secured party to the possibility of separate legal and beneficial ownership of the shares. So in the absence of a mandatory register of beneficial owners, publicly or privately available, how is a prudent secured party able to work out if there is a separate beneficial owner? The current position is that the secured party would make inquiries of the legal owner. This inability to independently verify the position stated by the legal owner would initially appear to be less than ideal, but the law has developed to protect the interests of the third party (be it the secured party or a potential purchaser of the shares in question).

It is still possible for the legal holder to transfer or encumber the legal title free from underlying equitable interests. This process is known as overreaching and can happen in broadly three ways: firstly, by the legal titleholder selling to a bona fide purchaser for value without notice (the proverbial “equity’s darling”); secondly, by the legal title holder selling in compliance with their powers under the terms of the relevant trust; or thirdly, in circumstances prescribed by statute (for example in the United Kingdom in relation to trusts of land, although there is currently no BVI statutory equivalent).

It is good practice for the share security document to include representations that the chargor is the legal and beneficial owner of the shares and for the charging clause to cover both the legal and beneficial ownership of the shares. The representation is designed to flush out the issue of a separate beneficial owner, and if it turns out that the trustee is incorrect regarding the absence of a separate beneficial owner of the shares, to hopefully put the secured party within the category of a bona fide purchaser without notice.

If a declaration of trust exists for the shares, then the secured party is concerned with the second category of overreaching: is the trustee charging the shares in exercise of his proper powers such that the secured party will, in enforcement, take title free of the underlying beneficial interests? If the granting of the security interest is outside of the trustee's powers, then any attempt to do so would be a breach of the trust.

So the secured party should examine the underlying trust documents (which may or may not be governed by the laws of the BVI), to check that the trustee does have the underlying powers to enter into the security document and to overreach the interests of the beneficial owners of the secured shares.

Ideally the beneficial owner would also be a party to the charging document as a chargor and would charge its interest in the shares of the company (the subject to the trust) or would acknowledge that the shares are being charged, although this may not be possible, for example, where there is a discretionary trust with a wide class of beneficiaries, some of whom may not exist yet or have contingent interests. The security document should also include the representation that the legal owner has the authority, under the relevant trust arrangements, to enter into the security document and to overreach the interests of the beneficial owners in the charged shares.

## Conclusion

At first glance it appears that the presence of a mandatory register of beneficial ownership, be it private or public, would be of assistance to lenders looking to take security over shares in a BVI company. Whilst it would undoubtedly facilitate the due diligence process to some extent, it would probably be unwise for any potential secured party to rely on the contents of a register at the exclusion of including the previously discussed ownership representations in the share security document. Furthermore the proposed register has been discussed in terms of ultimate beneficial ownership, and would not make clear whether the immediate shareholding is subject to trusts, or merely reflective of the ultimate ownership of the shareholder(s). Where a declaration of trust exists, the presence of a register would not absolve the secured party from checking that the trustee has the necessary powers to provide the security over the shares. Further, lenders advancing money in good faith may be at further risk of being found to have "constructive notice" of third party equitable interests, which may adversely affect their recourse to security. Nor would it assist the due diligence process for resulting or constructive trusts, which in the interests of brevity are not considered in this article.

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