

Lending and taking security in Bermuda: overview

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OVERVIEW OF THE LENDING MARKET

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

The recent downturn in the global economy has decreased the level of business activity in the lending market in Bermuda. In response, lenders have been renegotiating and extending loans, and protecting their security positions.

Lenders have also been enforcing their security. A number of major hotel and property development businesses have been placed in receivership in the past 12 months, and there has also been a marked increase in the number of actions to enforce mortgages over residential property. This latter development has highlighted the fact that under current Bermuda law it is time-consuming and expensive (and often difficult) to enforce claims against individuals, partnerships and trusts. This has resulted in proposals for law reform (see *Question 29, Reform*).

This chapter concerns security matters relating to companies regulated by the Companies Act 1981 (Companies Act). There are three broad company categories:

- **Local companies.** These provide goods or services in the local marketplace to Bermudians. They are subject to ownership and control restrictions.
- **Exempted companies.** These are not permitted to conduct business in the local marketplace except in limited circumstances or under a licence issued on application to the Minister of Finance (MOF). The majority of foreign-owned companies that are incorporated in Bermuda are registered as exempted companies.
- **Overseas or permit companies.** These are foreign companies that are entitled to do business in Bermuda under a permit issued by the MOF.

FORMS OF SECURITY OVER ASSETS

Real estate

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

Real estate

Real estate is comprised of:

- Land, including land covered by water.
- Immovable items located on land, for example:
 - buildings;
 - pools;

- fixtures;
- walls;
- fences; and
- improvements.

- Any estate, interest, right or easement in or over any land or building.

Title to land is unregistered. Bermuda has passed the Land Title Registration Act 2011 which will introduce a system of registration, but the legislation is not yet in force. Estates in land include freehold and leasehold. Leases can be long (typically 99 or 999 years) or short (typically three to five years).

Specific rules apply to companies acquiring land in Bermuda:

- A local company can:
 - acquire and hold land in Bermuda if:
 - permitted to do so under its memorandum of association;
 - it has obtained the MOF's authorisation; and
 - the acquisition or holding is required for the purpose of the company's business.
 - enter into a lease of land in Bermuda:
 - for a term not exceeding 50 years, provided that land is required for the purpose of the company's business; or
 - for a term not exceeding 21 years, with the MOF's consent, to provide accommodation or recreational facilities for its officers and employees.
- Generally, exempted companies cannot acquire land in Bermuda without the MOF's permission (*Companies Amendment Act 2014*). Exempted companies can enter into leases not exceeding 50 years for business purposes or, with the MOF's consent, for a term not exceeding 21 years to house employees and officers (*section 129, Companies Act*).

Common forms of security

The following forms of security are commonly used:

- **Legal mortgage.** A legal mortgage transfers the legal interest from the borrower (mortgagor) to the lender (mortgagee), subject to the borrower's right to redeem the property. The lender holds the legal title and the borrower retains possession.
- **Equitable mortgage.** An equitable mortgage is a contract that can be enforced under a court's equitable jurisdiction. The borrower transfers the beneficial or equitable interest to the lender and retains the legal interest and possession.
- **Equitable charge.** An equitable charge does not involve the transfer of the legal or equitable interest in, or possession of, property. It is an encumbrance on the borrower's property giving the lender the equitable right to sell the property for payment. A charge can be either:
 - fixed (attaches immediately to the borrower's asset); or

- floating (that is, a charge over a class of assets, which can later "crystallise" when certain events occur) and can potentially cover a rental lease forming part of the company's assets.

Formalities

The following formalities must be complied with:

- **Legal mortgage.** The mortgage must be created by a deed, and validly executed by the parties. The deed attracts stamp duty (see *Question 27, Documentary taxes*). The deed (and prescribed memorandum setting out the mortgage particulars) must be submitted to the Office of the Registrar General (section 1(1), *Mortgage Registration Act 1786* (MRA)). An entry is made in the Book of Mortgages maintained by the Registrar General in relation to land and the deed returned with the registration details noted on it. Priority is governed by the order in which mortgage deeds are deposited for registration. The lender then holds the title deeds.
- **Equitable mortgage.** The mortgage must be in writing (a deed is not required). It is commonly created by a memorandum of deposit of deeds outlining the terms under which the title deeds are deposited, which creates the equitable mortgage. All other formalities are the same as for a legal mortgage.
- **Charge.** The charge must be in writing and registered under the MRA, and the MRA determines the charge's priority. Charges usually must be registered with the Registrar of Companies (ROC) under section 55 of the Companies Act to protect priority over assets relating to property (such as lease payments).

Most mortgages over Bermuda real estate are held by Bermuda banks.

An overseas company (which, for this purpose, includes an exempted company) can hold a mortgage over land in its corporate name in the same way as a local company. However, if the total sum secured exceeds BD\$50,000, the MOF's consent is required (section 144(1), *Companies Act*). If the overseas company takes title to the property as part of the enforcement, the land must be sold within five years of taking possession. An overseas company also requires the approval of the MOF to enter into a mortgage or charge over land, as the company is considered a restricted person (section 80, *Bermuda Immigration and Protection Act 1956*), unless the company is either:

- Licensed under the Banks and Deposit Companies Act 1999.
- A non-resident insurance undertaking under the Non-Resident Insurance Undertaking Act 1967.

Tangible movable property

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

Tangible movable property

There is no statutory definition of tangible property. Common law principles determine whether something is tangible personal property. It is generally accepted that the following constitute tangible movable property:

- Machinery and equipment.
- Inventory.
- Consumer goods.
- Aircraft.
- Ships.

Common forms of security

The Companies Act defines the expression "charge" in very broad terms, and any interest created in property by way of security, including any mortgage, charge, assignment, pledge, lien or hypothecation of the assets of a company can be registered with the ROC. The nature of the specific tangible movable property determines the most suitable form of security:

- **Equipment, machinery and inventory.** The most common form of security for machinery and equipment is a fixed charge created by a debenture or a general security agreement. The most common form of security for inventory is a floating charge.
- **Aircraft and aircraft engines.** Where an aircraft is registered in Bermuda, the aircraft and the aircraft engines can be mortgaged in favour of a secured party. To register an aircraft, it must be legally or beneficially owned or chartered by a qualified person. Qualified persons include bodies incorporated and having their principal place of business in Bermuda. Very often, exempted companies are incorporated to act as special purpose vehicles (SPVs) to own aircraft registered in Bermuda. Security usually takes the form of a mortgage. The following are also common:
 - assignments of any charter agreements, insurances, warranties or aircraft leases relating to the aircraft (see *Question 5*). In addition, the borrower usually will deliver a deregistration power of attorney to the lender, the terms of which prohibit the borrower from deregistering the aircraft without the lender's consent;
 - charges over the shares of the company owning an aircraft; and
 - leasing or charter by demise arrangements, where the owner gives control and possession of the aircraft to the charterer. The charterer then becomes responsible for all responsibilities and liabilities associated with its operation.
- **Ships.** All types of commercial vessels and yachts can be registered in Bermuda with the exception of commercial fishing vessels. Only qualified persons can register ships in Bermuda, including companies incorporated in Bermuda, the UK, a UK possession or the EU. A Bermuda-registered ship can be used as security, usually through a ship mortgage.

Formalities

The following rules apply:

- **Equipment, machinery and inventory.** Charges by Bermudian companies over Bermuda property do not need to be registered to be valid and enforceable. However, the date of the registration of security documents determines the priority of charges or mortgages or other security documents, and therefore they are usually registered (see *Question 24*). Most charges are registered at the ROC under section 55 of the Companies Act for a local or exempted company and section 61 for an overseas company granting security over Bermuda property. The following must be filed with the ROC:
 - an original of the security document (certified copies will generally be accepted);
 - a Form 9 (particulars of a mortgage or charge); and
 - the appropriate fee (see *Question 27, Registration fees*).

The registration is effective as at the time of filing, and not at the time the certificate of registration is issued. Special registration requirements apply to certain assets such as aircraft and ships (see below).

- **Aircraft and aircraft engines.** The Governor of Bermuda maintains a Register of Aircraft under the Air Navigation (Overseas Territories) Order 2007, as amended (N/O 2007). The mortgage can be registered under the Mortgaging of Aircraft

and Aircraft Engines Act 1999 (Aircraft Mortgage Act) on the Aircraft Register or Aircraft Engine Register, as applicable. A mortgage registered under the Aircraft Mortgage Act has priority over an unregistered mortgage. Where more than one mortgage is registered over an aircraft, priority is determined according to the times that they were registered or priority notice filed.

However, the lender can apply to file a priority notice with the Bermuda Department of Civil Aviation (BDCA) in advance of the execution and delivery of an aircraft mortgage or aircraft engine mortgage. This provides notice of the lender's intention to file a mortgage. If a mortgage is entered into the Aircraft Register or Aircraft Engine Register within 14 days of the priority notice being filed, the mortgage is deemed to have priority from the time the notice was registered. Registration fees are payable on registration of a mortgage or priority notice (see *Question 27, Registration fees*). The statutory definition of "aircraft engine" includes all parts, equipment and data, and manuals and records relating to them.

If the aircraft mortgage grants a charge over assets that go beyond the scope of an aircraft or aircraft engine, the document should be registered under the Companies Act to protect the priority over those assets (see above). Charges over shares and other ancillary security documents are generally filed with the ROC to protect priority (see *Question 4*).

In leasing transactions, leasing documents are filed with the BDCA and are also generally registered under section 55 of the Companies Act at the ROC.

- **Ships.** A ship mortgage granted over a Bermuda registered vessel must be in the statutory form set out in the Merchant Shipping (Registration of Ships) Regulations 2003 and registered with the Shipping Register. As with aircraft, it is possible for the lender to deliver a notice of intention to take a ship mortgage to the Registrar of Shipping at the Department of Maritime Administration. This notice will protect the priority of the mortgage for a 30-day period, which can be extended for an additional 30 days. Priority of ship mortgages is based on the timing of registration or notice of intention.

Share charges and other ancillary security documents are generally filed with the ROC to protect priority. Filings can also be made with the ROC of mortgages over non-Bermudan registered ships.

The documentation for a leasing or charter by demise structure will vary, and registration of the documents will depend on their form. However, they will usually be registered at the ROC.

Financial instruments

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

Financial instruments

The most common types of financial instrument over which security is granted are shares issued by privately held companies.

Common forms of security

Bermudian companies are prohibited from issuing bearer shares. The most common form of security granted over certificated shares is an equitable mortgage. Legal mortgages of shares are rare in Bermuda practice.

Where shares are uncertificated, it is generally advisable to require that the shares be certificated for the purposes of obtaining an equitable mortgage, failing which, a fixed charge may be taken over uncertificated shares.

Where a Bermudian company gives security over dematerialised securities traded in a market outside Bermuda, the security is usually created in accordance with the laws of the place where the securities are situated and transferred. If the dematerialised securities are traded electronically on the Bermuda Stock Exchange (BSX) within the Bermuda Securities Depository (BSD), then the BSD regulations apply.

All securities held in the BSD are registered in the name of BSD Nominee Limited, which is a subsidiary of the BSX. All of the Bermuda banks are member participants in the BSD ("Member Banks"). When a Member Bank proposes to make a loan secured by the security provider's interests in securities held within the BSD, the security provider as beneficial owner ("BO") will instruct its broker to deliver the relevant securities within the BSD to the Member Bank as custodian on an intra-member basis.

The BO will also grant the Member Bank authority to sell the securities on an event of default, and thereby realise its security. For its part, the Member Bank as custodian will agree to re-deliver the securities to the BSD's broker when the BO discharges its obligations to the Member Bank.

Formalities

It is not mandatory for Bermuda law to govern a charge over the shares of a Bermudian company, although it is recommended. A charge over shares governed by Bermuda law will typically be executed as a deed. A share charge generally requires the delivery of ancillary documents to the chargee, including:

- Executed but undated share transfer forms and share certificates.
- Undated letters of resignation, letters of authority, and powers of attorney from the directors, and an irrevocable proxy from the shareholder.
- Evidence of approval of the directors of the company whose shares are being charged, if the bye-laws of that company so require.
- Certified copies of directors' resolutions approving the granting of the charge.
- An undertaking from the company, in the form of a deed, that it will register the share transfer form.

Share charges generally are registered with the ROC to protect priority.

Except in the case of shares listed on an appointed stock exchange, prior permission must be obtained from the Bermuda Monetary Authority (BMA) for the transfer of shares of an exempted company or a local company owned by a non-Bermudian. However, the BMA has granted a general permission under the Exchange Control Regulations 1973 for the granting of a charge to a licensed bank or licensed lending institution in Canada, the US, Australia, EU countries, Bermuda, Hong Kong, Singapore, Norway, Switzerland and Japan (*Notice to the Public dated 1 June 2005*). This permission extends to transfers to those licensed lenders on enforcement of the charge.

The general permission does not extend to:

- Charges over shares of Bermuda insurance companies.
- Sales by the licensed lenders to third parties as part of the enforcement process.

BMA permission is not required where the securities being charged either do not carry the right to vote for, or appoint one or more directors of the issuer, or are not by their terms convertible into securities carrying such rights.

Claims and receivables

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

Claims and receivables

The benefit of contractual rights claims under insurance policies and debts are the most common types of claim or receivable over which security is granted in Bermuda. In certain limited circumstances, it is possible to assign a cause of action. However, in practice, these assignments are very rare because of the public policy rules against maintenance and champerty. The proceeds of a cause of action can be assigned.

Contractual rights can be mortgaged by way of assignment, and an "all assets" debenture will typically provide a mechanism for taking security over the benefit of the security provider's interest in specific "material contracts". In addition, rights under insurance policies and the proceeds of any claims under them can be assigned.

In both instances, the assignment is perfected by giving written notice of the assignment to the counterparty of the material contract or the relevant insurer. The secured creditor may also require that its interest in an insurance policy's proceeds is noted on the policy by the insurer.

Debts can be mortgaged by way of assignment where the secured creditor becomes the owner of the debt. Alternatively, debts can be charged where security is being taken over a large pool of receivables, in which case the security will usually take the form of a floating charge.

Common forms of security

Security over large individual debts, such as inter-company loans, is usually granted through a mortgage of the debt effected by assignment to the secured creditor, with a proviso for reassignment to the mortgagor when the secured obligations have been discharged.

Formalities

The Supreme Court Act 1905 provides that a legal assignment (an unconditional assignment of the debt for the time being not by way of charge only) can be made by giving the debtor notice in writing of the assignment. An equitable assignment may be made without any requirement for notice or other formalities.

A legal assignment entitles the assignee to enforce the debt directly against the debtor. Where there has been an equitable assignment the assignee may convert it into a legal assignment by giving the debtor written notice of the assignment.

Both assignments and charges are generally registered with the ROC to protect the second creditor's priority (see *Question 3, Formalities*).

Cash deposits

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

In 1990, Bermuda enacted special legislation to deal with the uncertainty caused by the decision in *Re Charge Card Services Ltd [1987] Ch 150*. The Charge and Security (Special Provisions) Act 1990 expressly provides that a bank can take security over its own indebtedness to its customers.

Common forms of security

The most common form of security over a cash deposit is a "charge back" where a bank takes security over cash deposited with it, or

otherwise over indebtedness that it owes to the chargor. A charge back is perfected by attachment without further act.

Where security is created over a deposit with a Bermuda bank in favour of a foreign bank, the most common form of security is a control agreement where the Bermuda bank agrees it will not exercise any rights of set-off against the relevant account, and will not permit any withdrawals from the account without the foreign bank's consent. The security provider and the foreign bank will agree that the security provider is not permitted to make withdrawals from the relevant account or otherwise exercise any of its rights as beneficial owner of the cash deposit until the secured obligations have been discharged. The result is that the security provider's cash deposit becomes a "flawed asset".

Formalities

Charges over deposits are normally registered with the ROC (see *Question 3, Formalities*).

Intellectual property

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

Intellectual property

Security is commonly granted over a very broad range of so-called intellectual property rights and quasi-property rights. However, Bermuda law only recognises three traditional categories of intellectual property as having personal property status:

- Patents.
- Trade marks, and copyright and design rights.
- Licences in respect of trade marks, and copyright and design rights.

More modern forms of "colloquial" intellectual property, such as trade secrets and internet domain names are not strictly intellectual property.

The relevant legislation is contained in:

- The Patents and Designs Act 1930.
- The Trade Marks Act 1974.
- The Copyright and Designs Act 2004.

Trade marks and patents are registrable in Bermuda, whereas copyrights are not. However, unregistered trade marks and patents are supported by the common law torts of passing off and unfair competition, and the law relating to confidential information and trade secrets.

Common forms of security

When dealing with registered intellectual property, security will usually be taken in the form of a fixed charge. Lenders seeking security over unregistered intellectual property of significant value will normally do so by way of a legal mortgage.

When the intellectual property does not have significant value, the normal practice is to take security by way of a floating charge in a debenture that covers all classes of the company's assets.

Formalities

As a general rule, the security agreement that creates a mortgage or charge over intellectual property is executed as a deed. The security should be registered with the ROC to protect priority (see *Question 3, Formalities*). In the case of trade or service marks, it is not statutorily required that the security agreement be registered. However, the Registrar General recommends that such agreements

are recorded on the register maintained at the Intellectual Property Office (a division of the Registry General) against the registered number of the trade or service mark.

Problem assets

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

There are no particular types of property over which security cannot be granted.

Future assets

Security can be granted over future assets. It is possible to create a fixed charge over specifically identified future assets, provided that safeguards are put in place to ensure that when the future assets come into existence, the assets are under the control of the chargee. Generally, it will not be possible to create a fixed charge over all future property, and it is likely that only a floating charge will be available.

Fungible assets

Taking security over fungible tangible assets requires that the assets be appropriated to the agreement. It is possible to take charge over a class of assets, even where those assets are pooled and later changed, provided that the chargee has a sufficient degree of control over the changes and has the ability to decide that changes will not be made to the asset pool. To take effective security over a company's intangible fungible assets it is necessary to identify those assets.

Other assets

Certain assets may be incapable of assignment, for example, the company's rights under a licence granted by a governmental or regulatory body. Certain assets may contain covenants against assignment without third party consent.

RELEASE OF SECURITY OVER ASSETS

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

The security provider retains the equity of redemption in respect of the security assets. At the end of the security period, when the secured creditor is satisfied that all monies and other obligations owed to it by the borrower and the security provider have been indefeasibly discharged in full, the security will cease to attach to the security assets and the secured creditor will formally release the security provider from all of its obligations and undertakings to the secured creditor.

Normally, the relevant security document expressly states that the security assets will be released from the security at the end of the security period and reassigned to the security provider.

Formalities

Normally, the release of the security is recorded in a deed of release. Where the charge has been registered in the register maintained by the ROC, there is no requirement that the charge be de-registered, but the security provider will want to ensure that the register is updated to show that the relevant property is no longer encumbered. If the ROC is satisfied that the debt has been discharged or that any part of the security assets has been released from the charge, he can enter a memorandum of satisfaction in the register of charges. Typically, evidence of discharge or release takes the form of a confirmatory letter from the relevant secured creditor.

SPECIAL PURPOSE VEHICLES (SPVS) IN SECURED LENDING

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

SPVs, for example, as companies or special purpose trusts, are common where specific assets (such as, ships or aircraft) are being financed. It is also common to establish an SPV to act as the parent company to a company that is being acquired. This allows the assets, liabilities and operations relating to a ship or an aircraft to be contained in one entity.

In those circumstances, the lender may take security over the shares of the SPV instead of taking direct security over the assets. However, it is more common for a lender to take both security over the SPV's shares and direct security over the assets.

QUASI-SECURITY

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

In some jurisdictions, recharacterisation as security may result in security being held void for want of registration. However, this does not normally arise in Bermuda because Bermuda law does not generally require the registration of security. There is no published Bermuda case law on the issue of recharacterisation. It is likely that Bermuda courts would follow the approach taken under English law and not recharacterise properly structured transactions for sale and leaseback, title retention, factoring or hire purchase.

Sale and leaseback

Sale and leaseback transactions are not common in Bermuda.

Factoring

Factoring is not currently used in the Bermuda lending market.

Hire purchase

Hire purchase transactions are rare. Bermuda does not have any applicable consumer credit laws.

Retention of title

Retention of title is uncommon in Bermuda. However, it is used with equipment leases. It is expected that Bermuda courts would follow the case law developed by English courts, except where English case law is not applicable in local circumstances.

Negative pledge

A covenant by a company not to encumber its property does not create a security interest in any of the company's present or future assets. However, negative pledges are sometimes included in floating charges; they may assist the lender to assert the priority of his security interest against another lender who takes security over those assets with notice of the negative pledge. It is unlikely that this would be effective against an interest that takes priority, such as a fixed charge because:

- There is no requirement to register a charge or negative pledge.
- The Companies Act does not provide that anyone taking security from a company has constructive knowledge of the matters set out in the registration documents.

Other structures

No other structures are commonly used in Bermuda.

GUARANTEES

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

Guarantees are commonly used in financing transactions in Bermuda. The borrower's parent company or shareholders typically give guarantees to the lender. There is no equivalent in Bermuda to the English Statute of Frauds 1677, and no requirement that a guarantee obligation be evidenced in writing.

Guarantees can be created in:

- A loan or facility agreement, provided that the guarantor is also a party to that agreement.
- A separate document.

The guarantee can be limited to a pre-determined maximum amount or, in the case of guarantees given by regulated entities (for example, insurance companies), by reference to their statutory capital and liquidity requirements.

RISK AREAS FOR LENDERS

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

Financial assistance

The statutory rule against financial assistance was abolished by the Companies Act 2011.

Corporate benefit

Generally, a Bermudian company can (unless its memorandum of association or bye-laws provide otherwise):

- Grant security over the company's assets either in relation to its own liabilities or the liabilities of another party (including, for example, a parent company).
- Guarantee the debts of another party.

However, the directors of the company must exercise their powers in the best interests of the company. When meeting to consider a transaction, the directors should specifically discuss and form a view as to whether the proposed transaction is in the company's best interests. The minutes of the meeting should reflect that discussion and view.

Loans to directors

Loans (or guarantees or security in connection with loans) to the following are prohibited without the consent of shareholders holding 90% of the voting shares:

- Directors.
- Spouses and children of directors.
- Directors of certain related companies.

This general prohibition does not apply to loans or guarantees that a company gives in the ordinary course of its business.

Usury

Currently, there are no applicable interest limitation laws in Bermuda.

Others

There are insolvency risks concerning fraudulent preferences and floating charges (*see Question 22*).

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

Lenders cannot be liable under environmental laws simply through holding or enforcing security over real property.

STRUCTURING THE PRIORITY OF DEBTS

15. What methods of subordination are there?

Contractual subordination

Senior, mezzanine and junior secured creditors may enter a priority agreement or inter-creditor agreement whereby the parties agree among themselves to alter the priorities of their secured claims. Contractual subordination of debt is also possible.

In simple subordination, the junior creditor agrees not to make a claim during the debtor's winding up until all unsecured claims have been satisfied.

Turnover subordination arrangements are more favourable to the senior creditor than simple contractual subordination. In turnover subordination, the junior creditor agrees that the senior creditor is beneficially entitled to the junior creditors' claims, and amounts due to the junior creditor are turned over to the senior creditor until the senior creditor's claims are satisfied.

Structural subordination

So-called "structural subordination" is also possible where the junior creditor is a shareholder of the borrower rather than a lender to the borrower. This type of arrangement is not technically a subordination arrangement, but it has the same result.

Inter-creditor arrangements

Multi-bank loans often involve inter-creditor arrangements for the regulation of the respective rights of the lenders. All parties to be regulated should be party to the inter-creditor agreement. The parties to an inter-creditor agreement will normally include:

- The borrower.
- Any guarantors.
- The security providers.
- The security trustee on behalf of the lenders.
- The intra-group creditors (in cases where there is intra-group lending by members of the borrower's group).

The terms of the inter-creditor agreement typically:

- Record the order of priority of the lenders rights as secured creditors.
- Govern the lenders' rights to receive any payments from the borrower prior to enforcement.
- Regulate the rights of individual secured creditors to enforce any security held by them over the assets of the borrower.
- Contain undertakings by intra-group lenders that until the senior secured creditors have been repaid in full, they will not take any action that would prejudice the interest of the senior secured creditors including:
 - taking any action to wind up a member of the borrower group, or appoint a liquidator, receiver or similar person;
 - enforcing any security in respect of any intra-group debt;
 - taking any further security or guarantee in respect of intra-group debt;
 - accepting any payment (including any dividend or other distributions) in respect of intra-group lending, or exercise any right of set-off.

DEBT TRADING AND TRANSFER MECHANISMS

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

It is not common for debt to be traded in Bermuda. To the extent that it happens, it is done by way of assignment and the appropriate consents must be obtained (see *Question 5*). Registration reflecting the changes should also be filed in the various registries.

AGENT AND TRUST CONCEPTS

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

The agency concept is recognised in Bermuda. The agent bank is often the arranger of the facility, and is normally chosen by the syndicate members. An agency arrangement governed by foreign laws will be recognised by Bermuda courts.

Typically, the agent acts as a conduit for payments, and for dissemination of information to syndicate members. In a pre-insolvency situation, the agent bank usually represents the syndicate members in dealing with the enforcement of the lenders' remedies. On the liquidation of the debtor company, each lender bank may submit proof of debt or the agent bank may do this on behalf of the syndicate members, provided that the agent bank is able to submit a proof of debt on its own account.

18. Is the trust concept recognised in your jurisdiction?

The concept of a security trustee is well recognised in Bermuda. Generally, only the security trustee can enforce the security on the creditors' behalf, and the borrower's individual creditor is precluded from taking independent action against the borrower. By virtue of the UK Recognition of Trusts Act 1987 (Overseas Territories) Order 1989, trusts from other common law jurisdictions and certain types of similar concepts that apply in civil law jurisdictions generally are recognised in Bermuda.

ENFORCEMENT OF SECURITY INTERESTS AND BORROWER INSOLVENCY

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

The circumstances in which a creditor can enforce its rights and security concerning a loan are governed by the relevant documents' terms. Some documents provide for loans to be payable on demand. Others provide that loans are payable at the expiry of the term set out in the loan documentation and that term can only be accelerated on default. Events of default generally include failure to pay or comply with the loan agreement's other specified obligations, and the occurrence of an insolvency event.

The lender generally needs to give notice of demand or default before enforcing its security.

Methods of enforcement

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

The mechanism for enforcement depends on the remedies contained in the security documents:

- **Powers of sale.** Mortgages (over land or other assets) or charges generally contain powers of sale. In the case of mortgages over land, the Conveyancing Act provides for limited rights of sale and foreclosure.
- **Appointment of receiver.** The terms of the security may enable the lender to appoint the receiver. Alternatively, it may be possible to apply to the court for the appointment of a receiver.
- **Possession of assets.** A lender may be able to take possession of charged assets or be noted as the registered owner in the case of a security interest over shares (see *Question 5*).

The best enforcement action depends on the particular circumstances at the time.

Rescue, reorganisation and insolvency

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

A scheme of arrangement is available under section 99 of the Companies Act and a scheme may be used to effect the reorganisation of a company. There is a substantial body of English case law on schemes to effect the reorganisation of a company and on the relevant provisions of the Companies Act. Bermuda applies English law principles to the interpretation and implementation of schemes.

A scheme must be approved by a 75% majority in value and a number majority of each distinct class of creditors (and shareholders, if the scheme also involves shareholders) and sanctioned by the court.

The court has wide powers under section 102 of the Companies Act to deal with various ancillary matters under the scheme.

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

The start of insolvency proceedings against a Bermudian company may affect a creditor's ability to enforce its rights. All or part of a transaction may be attacked as constituting a fraudulent conveyance or a fraudulent preference. In certain circumstances, floating charges can also be attacked (see *Question 23*).

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

Fraudulent preferences

Security created within six months of the start of a company's winding up can be set aside on the application of the liquidator where the purpose of creating the security was to give a secured creditor preference over other creditors (section 237, *Companies Act*). Section 237 cross-references Bermuda's bankruptcy law regime, and section 47 of the Bankruptcy Act 1989 reproduces section 44 of the English Bankruptcy Act 1914. English or

Commonwealth cases on the meaning and effect of those provisions will be relevant to their interpretation in Bermuda courts.

The start of the winding up is either:

- The date that the company resolves that it be wound up.
- If there is no such resolution, the time of presentation of the petition that led to the winding up.

The legislation's intention is to avoid preferences at the expense of unsecured creditors. The presence of "fraud" on the company's part or the person who is being preferred is not required. However, it is necessary to show that the company's "dominant intention" was to prefer one creditor over other creditors. The burden of proof is on the liquidator, although the court can draw inferences about intention from all the relevant facts. Payments to secured creditors are normally not preferences. However, the granting of security may be a preferential transaction that can be set aside if the relevant intention exists.

Avoidance of floating charges

Floating charges that are created within 12 months before winding up commences can be set aside (*section 239, Companies Act*). This provision takes automatic effect, and is not dependent on the liquidator or creditor applying to set the floating charge aside. Floating charges are valid if the creditor provided new value (cash paid) at the time of, or in consideration for, the security. Otherwise, they are void to the extent that the creditor did not provide new value, unless the creditor can prove that the company was not insolvent at the time of the charge. The creditor is entitled to recover interest on the amount of money paid to the company at a statutory rate.

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

Secured creditors with fixed charges may realise their security outside the winding up regime. Secured creditors also may recover the full proceeds of realisation without deductions other than for enforcement expenses. Other creditors are usually paid in the following order on an insolvency:

- Secured creditors with fixed charges.
- Preferred creditors set out in section 236(1) of the Companies Act, including the government and municipalities' claims over taxes and rates.
- Employees, for up to BM\$2,500 of wages or salary relating to the four months before the liquidation or winding up, and accrued holiday pay.
- All amounts due in respect of:
 - contributions payable by the company for the preceding 12 months under the Contributory Pensions Act 1970;
 - any contract of insurance;
 - any accrued compensation; or
 - liability for compensation under the Workmen's Compensation Act 1965.
- Secured creditors with floating charges.
- Unsecured creditors.

The ranking of subordinated creditors depends on the nature of the subordination. A junior secured creditor is paid after a senior secured creditor, but before unsecured creditors. However, an unsecured subordinated creditor normally ranks after other general unsecured creditors. (*See Question 13*).

The priority of security depends on the registration date of the security document, priority notice or, in the case of aircraft, the notice of intention to file a mortgage. (*See Questions 2 to 6*.)

The registration of security is not mandatory and is not essential to the creation of valid security (*see Questions 2 to 7*). On insolvency, the failure of a secured creditor to perfect its security or register it as a charge does not entitle a liquidator to have the security set aside for the benefit of the company's unsecured creditors. The general position is that registration does not constitute perfection and so the method of perfection for a particular asset class is a matter of common law. Where a creditor has failed to perfect their security, there is a risk that a subsequent creditor with a security interest in the same asset may be able to achieve priority by being the first to register their security as a "charge".

On insolvency, secured creditors with fixed charges have priority over all other secured and unsecured creditors (*see above*). Registration affects priority between secured lenders. If no secured creditor has registered their security, priority is determined by the time of creation.

CROSS-BORDER ISSUES ON LOANS

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

Non-Bermudian companies are generally not permitted to own real estate in Bermuda and may require certain permissions to own shares in a Bermudian company (*see Questions 2 to 4*).

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

There are currently no restrictions in Bermuda on the making of payments by a company (local or exempted) to a foreign lender under a security document, guarantee or loan agreement, and exempted companies have never been subject to foreign currency controls. Bermuda's exchange control legislation has not been repealed.

TAXES AND FEES ON LOANS, GUARANTEES AND SECURITY INTERESTS

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

Documentary taxes

The Stamp Duties (International Business Relief) Act 1990 abolished stamp duty on most documents (including loan and security documents) executed by "international businesses" (including exempted and overseas companies). However, this exemption does not extend to stamp duty payable on instruments involving Bermuda real estate.

A legal mortgage attracts:

- Stamp duty at the rate of 0.25%, where the sum secured is no more than BM\$400,000.
- Stamp duty at the rate of 0.5%, where the sum secured is more than BM\$400,000.

Local companies are liable for stamp duty on the execution of most documents unless the relevant transaction can be brought within the relatively narrow statutory exemptions in section 46(c) of the Stamp Duties Act 1976.

Registration fees

The following registration fees are payable for a charge against a company at the ROC:

- Over exempted or overseas companies. BM\$328 where the amount secured is less than BM\$1 million; and BM\$574 where the amount secured is greater than BM\$1 million (*sections 55 and 61, Companies Act*).
- Over local companies: BM\$164.

The fee for the priority notice with the BDCA is BM\$80. The fees for registration of an aircraft mortgage:

- Where the amount secured by the mortgage does not exceed BM\$5 million, the fee is BM\$200.
- Where the amount secured by the mortgage does not exceed BM\$20 million, the fee is BM\$400.
- Where the amount secured by the mortgage does exceed BM\$20 million, the fee is BM\$800.

Notaries' fees

Stamp duty in the amount of BM\$25 is payable on all notarial acts, except for protests on bills of exchange or promissory notes. If there are exhibits to the document, an additional BM\$25 must be affixed to each exhibit.

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

Stamp duty generally is not payable when security is granted over the assets of an exempted company, so there is no need to structure a transaction to minimise Bermuda tax consequences (see *Question 27, Documentary taxes*). Where local companies are granting security, there may be ways to minimise the stamp duty payable, such as using one composite security document to cover various assets (see *Question 17*).

It is also possible to minimise registration fees by using a single document (see *Question 27, Registration fees*). However, registration fees are not usually a material issue in determining the structure of security arrangements.

REFORM

29. Are there any proposals for reform?

As noted above, the increase in enforcement activity by lenders has resulted in a number of proposals for law reform. Consideration is being given to the introduction of charging orders, modelled on the UK Charging Orders Act 1979. A Bermuda partnership may elect for legal personality at the time of its formation, and consideration is also being given to the creation of a registration system for charges over property owned by partnerships with legal personality, which would facilitate the introduction of more appropriate procedures for the enforcement of security against partnerships.

ONLINE RESOURCES

Bermuda Bar Association

W www.bermudabar.org

Description. The Bermuda Bar Association is the governing body for the legal profession in Bermuda. This is the association's official website and it is kept up-to-date.

The Bermuda Judiciary

W www.gov.bm/portal/server.pt?open=512&objID=204&mode=2&in_hi_userid=2&cached=true

Description. Official page of the Bermuda Judiciary, which is maintained by the Government and kept relatively up-to-date. The website provides a general introduction to Bermuda's court system, as well as more detailed information for the public and lawyers.

Supreme Court and Court of Appeal Judgments

W www.gov.bm/portal/server.pt?open=512&objID=204&&PageID=226633&mode=2&in_hi_userid=2&cached=true

Description. Official site for Supreme Court and Court of Appeal cases. The website is maintained by the government and kept up-to-date. It is possible to access full-text judgments from 2007.

Bermuda Laws Online (BLO)

W www.bermudalaws.bm/default.aspx

Description. BLO is a database of Bermuda's statutes and statutory instruments. It contains both consolidated laws as amended up to 25 February 2013 and annual laws from 1993. It is maintained by the government and kept up-to-date.

Bermuda Monetary Authority (BMA)

W www.bma.bm/SitePages/Home.aspx

The BMA is the integrated regulator of the financial services sector in Bermuda. Established under the Bermuda Monetary Authority Act 1969, the BMA supervises, regulates and inspects financial institutions operating in or from within the jurisdiction. The website is kept up-to-date.

Bermuda Parliament

W www.parliament.bm

Description. Official website of the Bermuda Parliament. The website is kept up-to-date.

Bermuda Registrar of Companies (ROC)

W www.roc.gov.bm

Description. This website provides on-line applications for service providers and companies currently doing business in Bermuda. It is maintained by the government and kept relatively up-to-date.

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