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ARTICLE

Margin Loan Financing in Developing Markets

Margin loan financing in developing markets can expose lenders to a number of risks, including their ability to liquidate shares provided by a borrower as collateral under the margin loan ("Collateral Shares"). Even if the Collateral Shares have the liquidity to facilitate timely enforcement, this does not prevent other difficulties which may be encountered in enforcing local law security (typically a pledge) over the Collateral Shares. These difficulties typically relate to:

(a) the ability to perfect local law security;

(b) the operation of insolvency stays under local law;

(c) the requirement for debtor consent or a public auction in connection with a sale of assets;

(d) local rules relating to the sale of assets, the identity of the purchaser and the price that must be achieved on the sale; and / or

(e) a non-creditor friendly insolvency regime.

A Solution Using Cayman Islands Exempted Companies[1]

If the margin loan financing is structured so that, in addition to obtaining local law security, various elements of the security package are located in the Cayman Islands, the lender can minimise the risks associated with the local jurisdiction in which the Collateral Shares and / or the borrower are located.

One possible solution using Cayman Islands exempted companies would be as follows.

The Collateral Shares held by the borrower would be transferred so that they are held through two Cayman Islands exempted companies. In this scenario, the first Cayman Islands exempted company (being a wholly owned subsidiary of the borrower) (the "Cayman Topco") would grant a Cayman Islands law governed equitable share mortgage (the "Cayman Share Mortgage") over the shares of the second Cayman Islands exempted company (its wholly-owned subsidiary) (the "Cayman OwnerCo" and, together with the Cayman Topco, the "Cayman SPVs") as security for the loan made available to the Cayman Topco's parent, the borrower.

The Cayman OwnerCo would hold the Collateral Shares, unless the local jurisdiction has foreign ownership restrictions on the Collateral Shares, in which case it may be possible for a special purpose vehicle to be incorporated in such local jurisdiction (or in a neighbouring jurisdiction that complies with the foreign ownership restrictions) to hold the Collateral Shares (the "Local Assetco"). In this scenario, the lender may also wish to take local law security over the shares in the Local Assetco. Irrespective of whether a Local Assetco is required (or whether the Cayman OwnerCo holds the Collateral Shares), the effect is that the Collateral Shares are no longer directly held by the borrower.

[1] Subject to the parties receiving appropriate tax advice (including, but not limited to, the borrower in its own jurisdiction and that of the Collateral Shares).

Upon enforcement, the lender can:

(a) enforce the local law security; and / or

(b) enforce the security it holds outside of the local jurisdiction's insolvency and security rules, being the Cayman Share Mortgage.

The Benefits of Using Cayman Islands Exempted Companies

The Cayman SPVs mitigate any enforcement risk associated with local law security by taking the ultimate control and ownership structure of the Collateral Shares out of the local jurisdiction and placing it into one which is creditor friendly. The Cayman Islands offer a number of benefits in this respect, in particular:

(a) the Cayman Islands give secured creditors the right to enforce security notwithstanding the winding up of the grantor of the security in the Cayman Islands: there is no concept of an insolvency stay;

(b) the Cayman Islands do not have any system of corporate rehabilitation enabling the borrower to effectively freeze or suspend the rights of creditors, including creditors' rights to enforce security interests;

(c) the Cayman Islands recognise self-help remedies upon enforcement of a Cayman Share Mortgage, such as the power of sale, without requiring a court proceeding;

(d) netting and set-off arrangements are recognised by express statutory provisions in the Cayman Islands and will be enforced both pre and post insolvency (assuming they are effective as a contractual matter under the governing law of the contract in which they are contained);

(e) the sale of shares in the Cayman Islands company (the "Secured Cayman Shares") must be made at the 'true market price' and there are no specific rules relating to the price which must be achieved on the sale;

(f) there is no prohibition on selling the Secured Cayman Shares to an affiliate of a secured lender;

(g) a secured lender is not required to sell the assets upon enforcement of a Cayman Share Mortgage by any particular method, for example, by public auction;

(h) liquidators of Cayman Islands companies cannot disclaim onerous contracts; and

(i) the Cayman SPVs can be incorporated quickly and the initial set-up costs and on-going maintenance costs are low.

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