Nominee arrangements as alternatives to mortgaging of securities

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In such instances, the borrower agrees to provide a perfected and notarized pledge over these assets, a legal tool which provides the beneficiary of the pledge with a controlled recourse mechanism at the time of enforcement. This mechanism entails, in large part, the involvement of the court and, ultimately, a public auction to sell off assets in order for the proceeds to satisfy, in full or in part, the outstanding debt obligation.

To avoid the above process, often lenders seek an alternative method of securing the assets. In the case of listed shares on the Kuwait Stock Exchange, lenders are happy to forego the formal mortgage over the shares by entering into a contractual nominee arrangement whereby the lender would become the legal owner of the shares by virtue of a contract entered into with the borrower. The borrower will then become the beneficial owner of the economic and beneficial rights relating to the shares. As legal owner of the shares, in the event of non-payment or default, the lender may seek to dispose/sell the shares and use the proceeds to satisfy the outstanding debt obligation (such arrangement as the “Nominee Arrangement”).

Implications under Kuwaiti Laws

The Kuwait Stock Exchange (the “KSE”), as controlled by the Kuwait Capital Markets Authority (the “CMA”), provides guidance on the regulations and procedures related to the transfer of title in listed shares. With respect to the Nominee Arrangement, we understand that it may be permissible in other GCC jurisdictions. However, pursuant to the laws promulgated by the KSE and CMA, it is not clear or straightforward. Specifically, the regulations issued by the CMA and the KSE do not specifically or explicitly provide for the ability to transfer listed shares between parties by virtue of a financing agreement. In fact, Article 122 of the CMA Law No. 7 of 2010, as amended, states that it shall be considered a crime to enter or purchase a sale order for a security with the knowledge that a counterparty is seeking to purchase or sell such security at the same or similar size, price and time pursuant to a side agreement between the buyer and the seller.

Notwithstanding, on 10 May 2015, an amendment was issued in the Kuwait Gazette which provided that the CMA shall publish a list of exemptions to the limitations imposed by Article 122. It appears that the legislators were intending to exempt situations where there is no effect on the market price of the listed shares pursuant to the side agreement between the buyer and seller. While the published amendment does not prescribe the applicable exemptions it states that they will be soon identified by the CMA which may give some comfort pending publication of the exemptions themselves.

To the extent that such publications exempt arrangements like the Nominee Arrangement, the lender and borrower should be careful to maintain compliance with all relevant regulations relating to lending and handling of security. Accordingly, language within the agreement should be drafted carefully in order to avoid violation of secured lending practices. Additionally, it should be noted that such Nominee Arrangement should also contemplate the custodian portfolio laws under the CMA regulations.

Summary

In summary, alternatives to placing a perfected pledge over listed shares may include arrangements such as the Nominee Arrangement, subject to its compliance with relevant regulations. A further alternative to consider is the use of issuing a floating pledge over a securities portfolio. While similar in nature to the Nominee Arrangement, this process, however, would ultimately require a court process for enforcement. It should be noted that a floating pledge of a portfolio account with a custodian can be made by a portfolio pledge agreement. The custodian would be a local financial institution licensed by the CMA to act as a custodian on behalf of the lender. Furthermore, lenders should note that a pledge over the portfolio (where assets are composed of shares) as opposed to a direct pledge over shares is usually a preferred structure for lenders and borrowers. It is a preferred structure as it enables both parties to replace/trade the underlying shares in the portfolio with simple procedures without a need to release the pledge and then noting a new pledge over the new shares each time there is a trade of the shares deposited in the portfolio.