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Pledging shares in Cyprus companies - security enforceable out of court

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A pledge over shares in a Cyprus company is an efficient form of security granted as collateral in commercial transactions, which can be enforced outside of court. A pledge creates a possessory security interest in the shares for the benefit of the creditor until outstanding obligations are fulfilled by the debtor.

Creditors should ensure that pledge agreements and deliverables are compliant with statutory formalities and procedures to ensure the enforceability of a security.

Creation of a pledge over shares

Strict adherence to statutory requirements concerning the creation of the pledge is imperative for the validity of the pledge. These include:

- Execution formalities – a pledge must be made in writing, signed by the pledgor and signed in the presence of two witnesses with contractual capacity
- Delivery of notice of pledge – a notice of pledge together with a certified copy of the pledge agreement must be delivered by the pledgee to the company whose shares are being pledged
- Memorandum of pledge – a memorandum of the pledge must be entered in the register of members of the company whose shares are being pledged in respect of the pledged shares
- Certificate of pledge – a certificate must be delivered to the pledgee that a memorandum of pledge has been entered in the register of members of the company whose shares are being pledged, evidencing the pledge.

The pledge agreement governs the pledge and sets out the requirements under the pledge, its deliverables and the enforcement mechanics in an event of default.

A pledge of shares under Cyprus law, is a possessory security and grants to the pledgee (the Lender) possession but not any right of ownership. The creditor retains possession of the pledged property (the share certificates) until the obligations of the borrower under the Pledge Agreement have been fulfilled.

Pledge enforcement

In the event of default, normal practice is that, on providing reasonable notice to the pledger, the pledge is enforced. The enforcement of the pledge takes place through implementation of the documents delivered under the pledge, without the need for judicial enforcement.

If the pledgor defaults on its obligations, the pledgee is entitled to sell the shares and retain the amount of the debt due. The pledgee has a duty to account to the pledgor for any surplus realized in excess of the secured amount.

A creditor enforcing by way of sale owes a duty to act in good faith and to take reasonable steps to obtain the best price possible. A prudent pledgee would request an independent valuation to demonstrate that it has discharged its duty to obtain a fair price.

A creditor must ensure it has immediate and unhindered access to enforce a pledge and sell the pledged shares in the event of borrower default. At a minimum, a creditor should determine whether there are provisions in the articles of the company (e.g. pre-emption rights or special transfer processes) which may need to be amended to ensure that the creditor's enforcement mechanism under the pledge is effective.

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