

An overview of the insolvency regime in Bahrain

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The Insolvency Law (Law No. 22 of 2018) and the Central Bank of Bahrain ('CBB') and Financial Institutions Law (Law No. 64 of 2006, as amended) ('CBB Law') are the primary pieces of legislation under which insolvency or analogous proceedings to which a company incorporated under the Companies Law (Law No. 21 of 2001, as amended) can be subject to in the Kingdom of Bahrain ('Bahrain'). The Insolvency Law applies to any company that is not licensed by the CBB. The CBB Law applies to any company that is licensed by the CBB. There are no laws that govern insolvency proceedings of an individual in Bahrain.

The CBB Law

The CBB Law covers insolvency of a CBB licensed entity ('Licensee'). Two options are available namely:

- (a) administration; and
- (b) compulsory liquidation.

The CBB Law provides that a Licensee is deemed to be insolvent if its financial position becomes unstable and it stops paying its due debts other than administrative fines and any applicable tax. Once a Licensee is insolvent, it must immediately cease to undertake any regulated services in Bahrain, make any payments or carry on any business in relation to regulated services, unless otherwise agreed in writing by the CBB. 'Regulated services' is defined as financial services provided by the financial institutions including those governed by Islamic Sharia principles under the CBB Law.

Administration

The CBB may assume the administration of a Licensee or appoint an external administrator to conduct the administration of the Licensee on behalf of the CBB, if:

- (a) the Licensee becomes insolvent or appears most likely to be insolvent;
- (b) the Licensee's licence is amended or cancelled due to failing to satisfy any of its licence conditions or failing to start business within six months from the date of the licence; or
- (c) continues to provide regulated services resulting in inflicting damage to the financial services industry in Bahrain.

Powers of the administrator

The CBB shall specify the terms and conditions under which an external administrator practises its duties and obligations and the administrator shall possess all the necessary powers to manage and run the business of the Licensee including the power to:

- (a) continue or temporarily suspend operations;
- (b) suspend or limit the discharge of financial obligations;
- (c) conclude agreements and sign documents on behalf of the Licensee
- (d) commence and defend any legal proceedings in the name of the Licensee; and/or
- (e) take any other legal proceedings to which the Licensee is a party.

The administrator may also:

- (a) declare a moratorium in respect of the debts of the Licensee;
- (b) discharge obligations of the Licensee to certain creditors in preference to other creditors, if this is to the advantage of the Licensee;
- (c) dismiss officers and employees, provided that reasons should be given for the dismissal;
- (d) appoint officers and employees;
- (e) nullify any agreement entered into by the Licensee (by way of a court order) before placing the Licensee under administration; and
- (f) undertake any necessary action in the interest of the Licensee, its customers and its creditors.

The administrator may, after obtaining the approval of the courts of Bahrain ('Bahraini Court(s)') and where applicable, the rights of the other party to be compensated, nullify any agreement (other than derivative contracts) entered into by the Licensee before placing the Licensee under administration if such action is in the interest of the Licensee or taken to protect the interests of its customers, or to avoid occurrence of irrevocable damage. This power would be used by the administrator under the supervision of the Bahraini Court if the administrator can satisfy the Bahraini Court that these actions are in the interest of the financial institution or to protect the interests of its customers or to avoid the occurrence of irrevocable damage. In practical terms, this power would be used where, for instance, retail depositors are unable to access deposits and the assets are required to be sold or to meet operating expenses of the financial institution.

Duties of administrator

Within 30 days of commencing the administration, the administrator shall compile two copies of an inventory of the rights, assets and liabilities of the Licensee. One copy should be kept at the principal place of business (available for inspection by creditors and stakeholders) and the other at the CBB. In accordance with the powers of the administrator, the inventory should be updated from time to time and the administrator should take all the necessary measures to collect all the entitlements due to the Licensee.

Suspension of proceedings

Any action in relation to enforcing any security over the property of the Licensee, legal proceedings or any other measures, may not be commenced or continued without the approval of the administrator.

Termination of administration

Within a period of two years from the commencement of the administration, the administrator shall submit a petition to the Bahraini Court for either compulsory liquidation of the Licensee or terminate the administration and restore the management to the officials of the Licensee.

Compulsory liquidation

The administrator, the Licensee or any creditor may submit a petition to the Bahraini Court for compulsory liquidation of the Licensee, and serve such petition at the Licensee's principal place of business. The petition should be made available to the shareholders and creditors of the Licensee and may be requested by any interested party. The entity or individual who submits the petition for compulsory liquidation should advertise the petition in the Official Gazette and in two Arabic and English newspaper at least 15 days before submitting to the Bahraini Court. The court shall then appoint a liquidator and determine their fees with the guidance of the CBB. All liquidator fees shall be borne by the Licensee.

Powers of the liquidator

The CBB Law provides that the appointed liquidator shall have all the powers necessary to carry out the compulsory liquidation and has the right to take any necessary measures to complete the process. In order to sell any assets or properties of the Licensee at a market value exceeding BHD 100,000 transfer or allocate any of the assets or properties as a security for a debt owed by the Licensee, settle any claim or waive rights exceeding the value of BHD 50,000, the liquidator must obtain the prior written approval of the Bahraini Court. Provided the approval of the Bahraini Court is obtained, the liquidator may (prior to placing the Licensee under liquidation) declare any agreement (other than derivative contracts) entered into by the Licensee, prior to placing the Licensee under liquidation, null and void if it is deemed to be to the advantage of the Licensee, its customers or to avoid irrevocable damage.

The Licensee under liquidation is prohibited from undertaking any of the following actions during the Prohibition Period (defined below), namely:

- (a) concluding any transaction at an undervalue with any person;
- (b) entering into a transaction for the purpose of defrauding any of its creditors;
- (c) giving preference to any person.

The term 'Prohibition Period' means:

- (a) a term of two years prior to the date in which the Licensee was placed under administration or the date on which the liquidation ruling was issued, if the date of the ruling does not precede the date of placing the Licensee under administration. This term applies to any transaction concluded, or priority given to any person related to the Licensee, in violation of the provisions stated above;
- (b) six months prior to the date of placing the Licensee under administration or the date of issuing the liquidation ruling if the Licensee was not placed under administration. This term applies to any transaction concluded, or priority given to any person who has no relation with the Licensee, in violation of the

provision set out above. A person is considered as being related to the Licensee if he or she is a member of the board of directors, an official or a partner of the Licensee.

Within 30 days of their appointment, the liquidator must notify all creditors of the Licensee under liquidation of the decision of their appointment. This notice should be served by recorded post in order to evidence receipt. Within 60 days of the decision to appoint the liquidator, the liquidator shall take necessary measures to terminate the activities of the Licensee. The liquidator should send application forms to all the creditors of the Licensee, accompanied by the notice mentioned previously. The form should make clear that if the creditor seeks to recover all or part of their debt; they should complete and return the form no later than 60 days from the date the form is dispatched.

Determination of claims

The liquidator should reach a decision on the claims submitted by the creditors, within 60 days following the expiration of the application form deadline, by either accepting totally, partially or rejecting the claim. The creditor should be notified of the decision in the form of a recorded letter and has the right to challenge the decision of the liquidator before the Bahraini Court within 15 days from the date of receiving the decision. With the Bahraini Court's approval, the liquidator may make partial distributions to creditors whose claims have been accepted. The final distribution will be made after all claims have been determined.

Priority of claims

The CBB Law provides for a priority of claims, determining the rights of interested parties in the property of the Licensee in liquidation namely:

- (a) administrator's fees and expenses incurred during the administration period of the Licensee, and the wages and salaries of officers and employees up to the date of petition for compulsory liquidation filed at the competent court;
- (b) liquidator's fees and expenses incurred during the period of liquidation;
- (c) fees and taxes due to the Government, its organisations, agencies and the CBB;
- (d) deposits and loans taken with the approval of the CBB to protect the Licensee from insolvency;
- (e) deposits of value not exceeding BHD 20,000 per depositor;
- (f) other deposits that exceed BHD 20,000 per depositor, and all other unsecured debts; and
- (g) amounts due to the shareholders in proportion to their respective shares.

Under the CBB Law the secured debts of the creditors of the Licensees shall be paid without reference to the order of priority set out in the CBB Law. Thus, in administration or compulsory liquidation a secured asset of the Licensee can be disposed of, however, the secured party would get the benefit of the proceeds of the secured assets ahead of any other creditors.

Insolvency Law

Under the Insolvency Law, both debtors and creditors may initiate insolvency proceedings by filing an application with the Bahraini Courts. An entity shall be deemed insolvent if the debtor has failed to pay its debts for a period of 30 days, is incapable of paying its financial liabilities as they fall due or the debtor's financial obligations exceed the value of its assets.

The Insolvency Law sets out two methods of resolving a failing entity namely:

- (a) restructuring; and
- (b) liquidation.

The Bahraini Court must first consider restructuring and order a restructuring of the debts of the debtor if it achieves a more favourable settlement for creditors than liquidation or if it is economically justifiable for a company to continue its business.

The administrative and management arm of the company remains in place and an independent insolvency trustee (i.e. an umbrella term used to describe an administrator or liquidator under the Insolvency Law) is appointed. The insolvency trustee owes a fiduciary duty to act in the best interests of the estate and performs a myriad of functions, including helping prepare the reorganisation plan and producing an inventory of the debtor's assets. The insolvency trustee (with assistance from the company) is required to submit a proposal for restructuring to the Bahraini Court within three months from the date insolvency proceedings were initiated.

The liquidator is responsible for selling the insolvency assets in accordance with a proposal for the sale of the insolvency assets and distributing proceeds to creditors in the order of priority set out in the Insolvency Law.

Moratorium

The Insolvency Law introduces the concept of a moratorium on claims against the insolvent's estate. The moratorium:

- (a) is triggered when the Bahraini Court commences the insolvency proceedings; and
- (b) lasts for an initial period of 120 days.

The stay on enforcement proceedings provides leeway to manage the reorganisation of the estate and encourages continued trade. The moratorium can be extended at the insolvency trustee's request, provided consent is obtained from the secured creditors or the Bahraini Court deems the extension as essential to maximising the estate's value. There are certain exceptions to the moratorium's scope. Financial derivative contracts are not subject to the stay. The Bahraini Court also maintains discretion to terminate the moratorium. Along with certain other conditions, the stay can be lifted upon the motion of a secured creditor if the value of their secured funds decreases and they do not receive adequate protection against impairment or any other losses during the moratorium. Unsecured creditors may apply to terminate the stay if their claim has been previously litigated or is subject to a right of set-off, but only where the adjudication of the claim or exercise of the set-off would facilitate administration.

Set-off

Set off is permitted before insolvency proceedings are initiated. However, once insolvency proceedings are initiated under the Insolvency Law, set off is only permitted pursuant to a court order if the debt is subject to a right of set off and set off effectively enhances the administration of the insolvency assets. The Insolvency Law does not apply to financial derivative contracts. An application for nullity may be submitted in accordance with the CBB Law and the Netting Regulations (Resolution No. 44 of 2014).

Invalidation of fraudulent and detrimental transactions

Fraudulent transactions and transactions at undervalue, preferences and invalid security interests can be set aside. The insolvency trustee can apply to the Bahraini Court to invalidate any transaction undertaken by the company or any obligation incurred by the company retroactively in the following cases:

- (a) if the company performs such transactions or incurs such obligation with intent to defraud its current or future creditors or with intent to cause damage to them;
- (b) if the company does not receive a fair consideration for such transaction or assumes an obligation which is not in the interest of the company in order to invalidate a transaction or obligation, the company shall be insolvent or become insolvent as a result of such transaction or obligation.

These provisions also apply to security interests.

An application for invalidating a transaction must be submitted within six months from the date insolvency proceedings are commenced and one year if it involves one of the company's 'insiders' namely a subsidiary institution, a member of the company's administration with significant control of company's institution, a person with access to non-public information about the debtor's decisions and financial situation; or the debtor's relatives until the fourth degree.

Treatment of unsecured, unsubordinated creditors of a counterparty under the Insolvency Law

Article 93 of the Insolvency Law sets out the priority of claims as follows:

- (a) secured creditors;
- (b) unsecured financing obtained after commencement of insolvency proceedings;
- (c) administrative costs and claims of the insolvency proceedings;
- (d) employee claims for due wages and financial benefits not exceeding BHD3,000;
- (e) customer claims for advance payment made to debtor for purchase of goods and services not exceeding BHD1,000 per customer;
- (f) claims of government agencies for taxes and or fees not exceeding BHD10,000 per agency;
- (g) unsecured claims arising prior to the commencement of insolvency proceedings;

(h) unsecured claims arising prior to the commencement of insolvency proceedings not filed within the stipulated timeframe but filed in a timely manner to determine right of distribution;

(i) claims of foreign government agencies (if any) for taxes and/or fees;

(j) unsecured claims as shareholders as compensation for late payment; and

(k) claims of shareholders for their ownership of shares.

Bahrain's insolvency regime represents Bahrain's business-friendly status as a country looking to facilitate the success of its investors and innovators.

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