

# BRIEFING NOTE

2021

## Guide: Granting and protecting security over shares in a Cayman Islands exempted company

Cayman Islands exempted companies are widely utilized in structuring cross-border finance transactions. One of the key reasons for this is that the Cayman Islands provides a flexible and well-tested regime for secured financing transactions that is attractive to borrowers and lenders alike. The process for creating security in the Cayman Islands is also straightforward and will not typically impact the timeframe of a proposed transaction.

In this brief guide, we address certain of the key Cayman Islands law points pertaining to the creation and protection of security over shares (the “**Secured Shares**”) in a Cayman Islands exempted company (the “**Secured Company**”).

### 1. Creation of security

The Companies Act (as Revised) of the Cayman Islands (the “**Act**”) does not contain any provisions with respect to the creation of security over Secured Shares in a Secured Company. Therefore, the security should adhere to the following principles derived from common law:

- i. it must be in writing;
- ii. the security document must be signed by, or with the authority of, the security provider; and
- iii. the security document must clearly indicate the intention to create security over the Secured Shares and the amount secured or how that amount is to be calculated.

Cayman Islands law recognizes various forms of security over assets, including equitable mortgages and charges which are most commonly taken over Secured Shares in a Secured Company.

### 2. Execution formalities and regulatory approvals

Cayman Islands law does not prescribe a particular mode of execution with respect to security over Secured Shares in a Secured Company and it is not necessary for such security to be certified, notarized or apostilled to make the security valid or enforceable from a Cayman Islands law perspective. That being said, in practice, a security document with respect to Secured Shares in a Secured Company is customarily executed as a deed.

From an execution standpoint, it is important to review the memorandum of association and articles of association (the “**M&A**”) of the relevant security provider and the relevant Secured Company, to the extent it is a party to the security document, to ensure compliance with any applicable signing formalities.

Unless security is being taken in a Secured Company which is a “regulated person”, such as a bank or a mutual fund, no regulatory approvals are necessary to create valid and enforceable security as a matter of Cayman Islands law.



### 3. Stamp duty and taxes

No stamp duty or taxes are payable with respect to the creation of security over Secured Shares in a Secured Company or upon any transfer thereof in an enforcement as a matter of Cayman Islands law so long as:

- (i) the security document and any ancillary documents thereunder are not executed or delivered in, brought into, or produced before a court of, the Cayman Islands; and/or
- (ii) the Secured Company does not have an interest in land in the Cayman Islands, or shares in a subsidiary that has an interest in land in the Cayman Islands.

### 4. Governing law of the security

Cayman Islands law permits security over Secured Shares in a Secured Company to be governed by Cayman Islands law or foreign law.

In cross-border finance transactions, it is relatively common for the governing law of a security document over Secured Shares in a Secured Company to be aligned with the governing law of the principal finance documents. One advantage of adopting a foreign governing law clause in a security document is that it may make available certain additional remedies (such as appropriation) which are not available under Cayman Islands law. Care should however be taken to ensure that there are no conflicts of law issues where a security document is governed by foreign law. English, Hong Kong and Singapore law are frequently adopted to govern security over Secured Shares in a Secured Company and no major conflicts of law issues are likely to arise.

#### Cayman Islands law governed security document

Where the security document is governed by Cayman Islands law, so long as it is in customary form, the secured party is entitled to the following remedies in the event of a default:

- i. the right to take possession of the Secured Shares in the Secured Company (subject to redemption by the security provider upon the settlement of the debt);
- ii. the right to sell the Secured Shares in the Secured Company; and
- iii. the right to appoint a receiver who may:
  - a. vote the Secured Shares in the Secured Company;
  - b. receive distributions in respect of the Secured Shares in the Secured Company; and
  - c. exercise other rights and powers of the security provider in respect of the Secured Shares in the Secured Company.

If the secured party acquires legal title to the Secured Shares in the Secured Company, it also has a right of foreclosure. This remedy extinguishes the security provider's legal and beneficial title to the Secured Shares in the Secured Company but not its obligation to pay any secured and unpaid sums. Foreclosure involves a time-consuming and costly court process and is not usually exercised in practice given its draconian nature.

For further details regarding the enforcement of security over Secured Shares in a Secured Company, please refer to our guide entitled "Enforcing security over shares in a Cayman Islands exempted company".

#### Foreign law governed security document

Where the security document is governed by foreign law, the:

- i. security document should comply with the requirements of its governing law to be valid and binding; and
- ii. remedies available to a secured party are governed by the governing law and the terms of the security document.



## 5. Application of proceeds of enforcement

Subject to any provisions to the contrary in the security document, all amounts that accrue from the enforcement of the security document are applied in the following order of priority:

- i. firstly, in paying the costs incurred in enforcing the security document;
- ii. secondly, in discharging the sums secured by the security document; and
- iii. thirdly, in paying any balance due to the security provider.

## 6. Security deliverables

The terms of a well-drafted Cayman Islands law governed security document with respect to Secured Shares in a Secured Company and the principal finance document will usually require the security provider to deliver the following documents to the secured party to assist with an enforcement:

- i. any original share certificate(s) with respect to the Secured Shares in the Secured Company;
- ii. an undated share transfer form with respect to the Secured Shares in the Secured Company;
- iii. an undated resignation letter from each director of the Secured Company;
- iv. a letter of authorization from each director of the Secured Company authorizing the secured party to date each undated letter of resignation upon the occurrence of a default under the security document;
- v. an irrevocable proxy with respect to the Secured Shares in the Secured Company in favor of the secured party;
- vi. a letter of instruction to the Secured Company's registered office service provider containing, among other things, directions to register a transfer of Secured Shares in the Secured Company upon the occurrence of a default under the security document;
- vii. a letter of acknowledgement from the registered office service provider with respect to the instructions referenced in the letter of instruction;
- viii. if the security provider is a Cayman Islands exempted company, a certified copy of its register of mortgages and charges showing the security created over the Secured Shares in the Secured Company (see further below);
- ix. a certified copy of the Secured Company's register of members annotated to show the security created over the Secured Shares in the Secured Company (if commercially agreed - see further below);
- x. if the security provider is a Cayman Islands exempted company, a copy of the board resolutions of its board of directors authorizing:
  - a. its entry into and execution of the security document; and
  - b. the updates to its register of mortgages and charges;
- xi. a copy of the board resolutions of the Secured Company authorizing:
  - a. its entry into and execution of the security document (if it is a party);
  - b. its register of members to be annotated (if commercially agreed); and
  - c. a transfer of Secured Shares in the Secured Company upon the occurrence of a default under the security document; and
- xii. a special resolution passed by the Secured Company with respect to certain changes to its M&A, if required (see further below).



## 7. Security protection steps

### Register of mortgages and charges of a Cayman Islands security provider

Pursuant to section 54 of the Act, if the security provider is a Cayman Islands company, it must record particulars of the security created over any Secured Shares in the Secured Company in its register of mortgages and charges. The register of mortgages and charges must include:

- i. a short description of the property mortgaged or charged;
- ii. the amount of charge created; and
- iii. the names of the mortgagees or persons entitled to such charge.

There is no statutory timeframe within which the register needs to be updated. However, a well-advised secured party will request that the register is updated promptly so that third parties that inspect it are on notice of the security.

Any variations and releases of charge should also be reflected in the register of mortgages and charges.

As there is no statutory regime for registering security interests under Cayman Islands law, the common law rules of priority continue to apply. In general terms, these rules specify that priority between competing security interests is determined by the dates on which the relevant security interests were created. It is important to note that inserting details of mortgages and charges in the register of mortgages and charges of a Cayman Islands company does not confer priority on a charge in respect of the relevant secured asset.

### Register of members of the Secured Company

A Secured Company may annotate its register of members to include:

- i. a statement that security has been created over the Secured Shares;
- ii. the name of the secured party; and
- iii. the date on which the statement and the secured party's name are entered in its register of members.

Although it is optional to annotate a Secured Company's register of members with details of any security that has been created, this puts third parties that inspect the register on notice of the security. Therefore, a secured party usually insists on this.

### M&A of the Secured Company

A secured party will usually request the Secured Company to make certain changes to its M&A to ensure, among other things, that there are no restrictions on the transfer of Secured Shares in the Secured Company which may impede enforcement action. Any changes to the Secured Company's M&A must be made by passing special resolutions. Although such resolutions need to be filed with the Registrar of Companies of the Cayman Islands within 15 days of being passed, they take effect upon signing.



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