

# Taking security over shares in a Cayman Islands company and interests in a Cayman Islands exempted limited partnership

This guide discusses the Cayman Islands law requirements when taking security over shares in a Cayman Islands exempted company (a **company**) and interests in a Cayman Islands exempted limited partnership (a **limited partnership**).

## Is it possible to take security over shares in a Cayman Islands company or interests in a Cayman Islands limited partnership?

Yes. Cayman Islands law allows security to be taken over shares in Cayman Islands companies and interests in a Cayman Islands limited partnership and this is a common feature of secured financing transactions involving Cayman Islands companies and limited partnerships. There is no statutory security regime in the Cayman Islands however and the grant, perfection and enforcement of security over shares and limited partnership interests and the methods used are largely based on English common law principles applicable in the Cayman Islands.

Taking security over limited partnership interests is a different concept to taking security over one or more of a limited partner's rights under a limited partnership agreement, which is not covered in this guide.

## What type of security interests are typically created over shares in a Cayman Islands company or interests in a limited partnership?

An equitable mortgage and a fixed charge are the most commonly used security interests when taking security over shares in a Cayman Islands company.

A legal mortgage can also be used although this is rare and would only be used when there is a transaction specific reason to do so. If a company's shares are held in dematerialised form then an account charge will be the most appropriate type of security interest.

An equitable assignment and a fixed charge are the most commonly used security interests when taking security over

limited partnership interests, as these are a different type of legal property to shares under Cayman law.

## What is the difference between an equitable and a legal mortgage?

Under an equitable mortgage, the legal title to the shares remains with the owner (**Borrower**), with the person taking the security (**Lender**) receiving a beneficial interest in the shares. The Lender is also typically granted certain further protections, as described below, to help the Lender (or their nominee) enforce their security and become the legal owner of the shares if there is an event of default. A good faith purchaser of the secured shares for value, who does not have notice of the equitable mortgage, will take ownership of the shares free from an equitable mortgage. This makes it a weaker form of security than a legal mortgage.

A legal mortgage requires legal title in the shares to be transferred to the Lender, with an obligation to transfer them back once the underlying secured obligations have been fulfilled. The shares will be registered in the name of the Lender, or its nominee, which can lead to accounting, regulatory, tax and legal issues for the Lender, eg if the whole or majority of the issued share capital of the company is charged and the Lender is then obliged to prepare consolidated accounts incorporating the company. These issues make equitable mortgages by far the more popular form of security over shares in a Cayman Islands company.

## What is the difference between an equitable and a legal assignment?

Similarly to shares, a limited partner (**LP Borrower**) can grant a legal or equitable assignment of its limited partnership interest to a Lender.

Under an equitable assignment, the LP Borrower retains legal title to its limited partnership interest and assigns the equitable interest to the Lender. The Lender will be granted similar protections to those when taking share security, with the same aim of helping the Lender (or their nominee) enforce their security and become the legal owner of the limited partnership interest if there is an event of default.

As with a legal charge, under a legal assignment the Lender takes full legal title to the LP Borrower's limited partnership interest when the security is perfected. This creates similar issues for the Lender to those when taking a legal mortgage over shares, making equitable assignments the most popular form of taking security over limited partnership interests in a Cayman Islands exempted limited partnership.

To perfect an equitable or legal assignment over limited partnership interests:

- **The general partner must give written consent**, before any security interest can be granted or a secured limited partnership transferred, subject to the limited partnership agreement.
- **Written notice of the security interest** with prescribed information must be served on the limited partnership by either the LP Borrower or the Lender, and the order of priority of security interests is determined by the time those notices are served.

### **Are there any filing requirements with the registrar of companies in the Cayman Islands or other restrictions, or other similar provisions of Cayman Islands law which apply?**

It is not possible to make any public filings in the Cayman Islands for either an equitable or legal mortgage over shares in a company or an assignment over interests in a limited partnership. If the Borrower is also a Cayman Islands company or a limited partnership, it will need to include details of the charge in its register of mortgages and charges (or its register of security interests if it is a limited partnership), although failure to do so does not invalidate the security granted. Please see our [Guide to registering security interests created by Cayman Islands exempted companies](#) for more details.

### **Are there other documents that are usually obtained when taking security over shares in a Cayman Islands company or interests in a limited partnership?**

With equitable mortgages, as well as entering into a written agreement setting out the terms of the mortgage, various further protections are typically granted to enhance the security provided, including:

- **Executed undated share transfer form in blank**, to allow the transfer of the shares into the name of the Lender, delivered by the Borrower, together with any share certificates issued for the secured shares.
- **Executed undated letters of resignation from director/s** appointed by the Borrower, together with a letter from each director granting the Lender authority to date and deliver the resignation letters. If any new directors are appointed after the security has been granted, executed undated letters of resignation should also be obtained from them.
- **Power of attorney**, enabling the Lender to perfect and enforce its security, including by executing a transfer of the shares into its name and to date and deliver the share transfer form and letter/s of resignation, if the Borrower defaults. The power will be irrevocable, as it is granted by way of security.
- **Notation on the company's register of members and, in certain circumstances, the register of beneficial ownership** that the shares are mortgaged. This is frequently used to make sure that any person reviewing the share register or register of beneficial ownership has actual notice of the security interest (and it is arguable that the notation amounts to constructive notice as well). The register of beneficial ownership will need to include details of the mortgagor if the mortgagor exercises significant influence or control over the company, which will depend on the terms of the mortgage. Only the company can insert the details on the share register and register of beneficial ownership, so the security document should contain an obligation to procure this is done simultaneously with, or promptly after, the grant of the security. The register of members and register of beneficial ownership of an exempted company are not open to the public in the Cayman Islands.
- **Articles of association**: it is typical to include amendments to the articles of association to limit or even completely remove the directors' discretion to approve and refuse the transfers of shares where the shares are validly secured. This underpins the usual contractual undertakings given by the charged company to comply with enforcement proceedings, by constitutionally binding the directors to comply (or ensure they have no discretion to frustrate enforcement proceedings). Other standard amendments include the disapplication of the company's rights to liens, calls and forfeiture provisions over the secured shares.
- **Contractual undertakings by the charged company**: the company may be made party to the charge or be required to enter into a separate deed of undertaking with the Lender to expressly undertake, for example, to register any share transfers received from the Lender following an event of default, and agree not to make any subsequent amendments to the share transfer provisions in the memorandum and articles of association (**M&A**).

- **Instruction letter to the registered office provider:** notifying the company's registered office provider that the shares are subject to a security interest and instructing the registered office provider, for as long as the security remains in place, to annotate the register of members with details of the security interest and, if instructed by the Lender, to register the transfer of the secured shares to the Lender (or its nominee) following an event of default.

For an equitable assignment of a limited partnership, these protections include:

- **Written consent and undertaking from the general partner** to the grant of security over a limited partnership interest and to the transfer of that limited partnership interest on enforcement of the security. The general partner should also undertake to update the register of security interests and annotate the register of limited partners on receipt of a valid and duly executed notice of grant of a security interest and, if security is enforced, to register the transfer of the limited partnership interest to the Lender (or its nominee) following an event of default
- **Executed undated transfer of limited partnership interest**, to allow the transfer of the limited partnership interest into the name of the Lender, delivered by the LP Borrower.
- **Power of attorney**, enabling the Lender to perfect and enforce its security, including by executing a transfer of the limited partnership interest into its name and to date and deliver the transfer form if the LP Borrower defaults. The power will be irrevocable, as it is granted by way of security.
- **Notation on the company's register of limited partners** that the limited partnership interest is assigned. While the limited partnership must maintain a register of security interests recording the assignment, this additional measure is frequently used to make sure that any person reviewing the register of limited partners has actual notice of the security interest (and it is arguable that the notation amounts to constructive notice as well). Only the general partner (or a registered officer provider on its instruction) can insert the details on the register of limited partners and register of security interests, so the security document should contain an obligation to procure this is done simultaneously with, or promptly after, the grant of the security. The register of limited partners and register of security interests of a limited partnership are not open to the public in the Cayman Islands.
- **Instruction letter to the registered office provider** from the general partner, if relevant, notifying the limited partnership's registered office provider that the limited partnership interest is subject to a security interest and instructing the registered office provider, for as long as the security remains in place, to update the register of security interests and annotate the register of limited

partners with details of the security interest and, if further instructed by the general partner if security is enforced, to register the transfer of the limited partnership interest to the Lender (or its nominee) following an event of default.

Other more conservative protections can also be provided, such as delivery of the original register of members to the Lender to allow the Lender to control updates of the register, and in the case of a company, applying to the Grand Court for a stop notice to prevent any transfer of the shares being registered on the register of members (which is *prima facie* evidence of legal title to shares in a Cayman Islands company) until 14 days after the company has given the Lender notice of the proposed transfer or the Lender being issued a special share with no economic rights but having the right to approve amendments to the M&A as they relate to transfers of shares. Please contact your usual Harneys contact for further details.

### Does the security document need to be governed by Cayman Islands law?

No, although it is common for security documents for shares in Cayman Islands companies or interests in a limited partnership to be governed by Cayman Islands law and it avoids a two-step enforcement procedure. The security document can also be governed by the laws of another common law jurisdiction, such as England, Hong Kong or Singapore, depending on the commercial requirements of the parties, and where shares are held in a custodian account and the charge amounts to security over a contractual right, the appropriate law will be the law of the jurisdiction where the account is located.

### Are any taxes payable on a security document over shares in a Cayman Islands company or interests in a limited partnership?

If the security document is executed outside the Cayman Islands, no stamp duties or other similar taxes are payable on it. If the document is executed in the Cayman Islands or brought into the Cayman Islands, for example in connection with court proceedings, stamp duty would be payable at a fixed amount plus an *ad valorem* portion, and is capped at CI\$500 or US\$600; this capped rate will be the applicable rate on most of the equitable mortgages over shares that we see.

### Can a security interest be enforced without appearing before the Cayman Islands courts?

Generally, yes. If the security document is governed by Cayman Islands law, then a number of possible remedies out of court are likely to be available to the Lender under the terms of the security document. The most common remedy is to appoint a receiver who can vote the shares, receive

dividends and (if they can find a market) sell the shares or limited partnership interest. In exercising a power of sale, there is a duty to take reasonable care to obtain the best price for the shares or limited partnership interest reasonably available at the time and, in the case of a company, the Lender may not sell the secured shares to itself, either alone or with others, unless the sale is made by the Grand Court and the Lender has obtained leave to bid (as such a transaction would amount to foreclosure without the leave of the court). A power of sale can also be exercised without recourse to the Grand Court. Exercising a right of foreclosure, however, does require an application to the Grand Court.

If the security document is governed by a foreign law, the means of enforcement will be determined by that law, which may also not require any application to be made to the Grand Court in the Cayman Islands, although if there is a dispute then it is likely that any foreign judgment will need to be recognised in the Cayman Islands.

### **How can a person taking security check free and marketable title to the shares or limited partnership interest?**

As there is no requirement to file any documents with the registrar of companies on the creation of security over shares in a company or interest in a limited partnership, it is not usually possible to determine from publicly available documents if any existing security interests have been created over the shares or interest.

For a limited partnership, the Lender should always check the register of security interests and register of limited partners.

For a company, the Lender should always inspect the register of members to check if any security interests are noted there and that the shares are recorded as being fully paid up. The Lender should also inspect the register of beneficial ownership to check if any security interests are noted there and to check that no restrictions notice affecting the transferability of the secured shares is noted as having been issued. Please see our [Guide to the Cayman Islands Beneficial Ownership Regime](#) for more details on restrictions notices.

### **Does the person taking security need to review the constitutional documents of the company or limited partnership?**

Yes. Although it is fairly simple to take security over shares in a Cayman Islands company, the M&A may contain provisions which could potentially frustrate a Lender trying to enforce their security over the shares. The M&A should therefore be reviewed carefully to check the mechanics for transfers of shares and whether they can only be transferred with the approval of the board of directors. If the directors refused to pass a resolution approving a transfer, it would be very difficult to exercise a power of sale of shares in the company if the Borrower defaulted on its obligations. The M&A should also be checked to confirm whether the company itself has a lien over the secured shares for any amounts due from a shareholder which could take priority over any subsequent security interests. The M&A are not publicly available in the Cayman Islands and so certified copies are typically obtained via the company's registered office provider, which requires the consent of the company.

For a limited partnership, a Lender should undertake a similar review of the limited partnership agreement.

### **Does the security document need to be notarised or apostilled?**

No, there is no requirement under Cayman Islands law that a security document relating to shares in a Cayman Islands company or interests in a limited partnership has to be notarised or apostilled.



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