

BRIEFING NOTE

2021

Guide: Enforcing 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.

In this brief guide, we address certain of the key Cayman Islands law points pertaining to the enforcement of an equitable mortgage over shares (the “**Secured Shares**”) in a Cayman Islands exempted company (the “**Secured Company**”). An equitable mortgage is the most popular form of security over Secured Shares in a Secured Company.

For details regarding the creation and protection of security over Secured Shares in a Secured Company, please refer to our guide entitled “Granting and protecting security over shares in a Cayman Islands exempted company”.

1. Security deliverables and power of attorney

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 – the secured party may date this and insert details of the transferee in an enforcement for the purposes of transferring the Secured Shares to itself or a nominee;
- iii. an undated resignation letter from each director of the Secured Company – the secured party may date these in an enforcement for the purposes of removing the existing directors 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 – this can assist the secured party in taking control of the Secured Company before a transfer of Secured Shares in the Secured Company has been completed;
- 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 contained 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 - refer to our guide entitled "Granting and protecting security over shares in a Cayman Islands exempted company" for further details;
- 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) - refer to our guide entitled "Granting and protecting security over shares in a Cayman Islands exempted company" for further details;
- 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 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 memorandum of association and articles of association (the "**M&A**"), if required - refer to our guide entitled "Granting and protecting security over shares in a Cayman Islands exempted company" for further details.

A well-drafted share mortgage will include an irrevocable power of attorney granted by the security provider in favor of the secured party enabling it to date and complete the share transfer form in respect of the Secured Shares in the Secured Company and the other documents requiring completion on enforcement.

2. Enforcement rights and remedies

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

Cayman Islands law governed equitable share mortgage

Power of sale

A secured party will usually acquire a power of sale:

- i. as a matter of common law; and
- ii. as a matter of contract pursuant to the terms of the security document.

It is not necessary to obtain a court order to exercise the power of sale, though it may be preferable to do so in certain circumstances. For example, if the secured party wishes to buy the Secured Shares in a Secured Company or sell them to a third party in a depressed market, a court order may protect the secured party from a claim that it did not receive the best price reasonably obtainable.

Receivership

A secured party will acquire the right to appoint a receiver as a matter of contract pursuant to the terms of any well-drafted security document. This is the most common method of enforcing share security and is an out of court procedure.

Once a receiver has been appointed, it can vote and sell the Secured Shares in the relevant Secured Company, as well as receive any distributions from the Secured Shares. A receiver will usually remove the Secured Company's existing directors once appointed and liquidate the Secured Company's underlying assets to facilitate repayment of the debt.

Taking possession

The secured party may also take possession of the Secured Shares in a Secured Company by becoming registered as the legal owner of the Secured Shares. It can do this by dating and completing the share transfer form and presenting it to the Secured Company's registered office service provider for the purposes of updating the Secured Company's register of members. It can then also exercise any shareholder rights that become available.

Foreclosure

If the secured party acquires legal title to the Secured Shares in a 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.

Foreign law governed share 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.

3. 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.

4. Stop notices

If the secured party has concerns that the security provider may transfer the Secured Shares in the relevant Secured Company to a third party or pay a distribution with respect to them in breach of the terms of the security document before any enforcement action has been completed, it may be possible to obtain a stop notice.

A stop notice does not require a court hearing and is obtained from the Registrar of the Grand Court (the "**Registrar of the Court**"). Upon a successful application, the Registrar of the Court issues a stop notice requiring 14 days' notice to be given to the secured party before any transfer of Secured Shares in the relevant Secured Company or any payment of a distribution with respect to them can occur.

5. Rectification of the register of members

To the extent that the registered office service provider of a Secured Company is uncooperative in updating the register of members of that Secured Company to reflect a transfer of Secured Shares, the secured party may apply to court to rectify the register on the grounds that there has been an unnecessary delay in entering it as a new shareholder.



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