Security over shares of a Cayman company

Insights - 19/05/2023

An exempted company is the most common form of Cayman company and this client briefing seeks to address the issues involved when security is granted over shares in a Cayman exempted company.

For information relating to the enforcement of an equitable security over shares in a Cayman exempted company please see our briefing Enforcing security over shares of a Cayman company.

Nature of exempted company shares

The ownership interests in an exempted company are registered (i.e. book entry) shares. Legal title to shares derives from entry in the register of members, and it is typical for a company's constituent documents (i.e. the memorandum and articles of association) to provide that the company will not recognise any interest in shares other than the interest of the registered holder, whom it treats as the legal and beneficial owner.

Security

There are two ways of taking security over shares of an exempted limited company, either a legal charge or an equitable charge.

In practice, the taking of security by way of an equitable charge over shares is the most commonly used method by a secured party. Accordingly, we have focused on this method in this client briefing while also providing a high-level summary of what is involved in a legal charge.

Legal charge

A legal charge over shares is created by the transfer of the shares into the name of the secured party, or its nominee, and the registration of that person as a holder of the charged shares in the register of members of the Cayman company. The secured party undertakes to re-transfer the shares on discharge of the secured obligations.

One of the key advantages of a legal charge is that it is a very secure and comprehensive form of security interest as it prevents the chargor from dealing with the shares while they are subject to the charge. In addition, if it becomes necessary to enforce the security, the secured party is already in control as the registered owner of the charged shares.

The disadvantages of a legal charge include that there may be tax, legal, regulatory and/or accounting implications for a secured party in taking legal title to the charged shares.

Equitable charge

An equitable charge transfers only the beneficial interest in the charged shares to the secured party, with the legal title remaining with the chargor. The chargor remains entitled to all the benefits deriving from, and the rights attaching to, the charged shares subject to any contractual restrictions contained in the security document relating thereto.

The key advantage to this type of security as compared to a legal charge over the shares is that it avoids the issues described above in respect of the secured party becoming the registered holder of the shares at the outset.

There are disadvantages to the taking of an equitable charge and we will describe some of these below, as well as a number of steps which can be taken to help mitigate these.

The key disadvantages of an equitable charge are:

- the directors of the company whose shares are being charged will typically have a power under the company's constituent documents to decline to register a transfer of shares and may elect to refuse to register the share transfer submitted by the secured party upon enforcement of the equitable charge
- a fraudulent or negligent chargor, having remained the registered holder of the charged shares, could transfer the shares held by it to a third party. Since the company whose shares are being charged does not recognise the rights of anyone other than the legal holder of the charged shares, should such a fraudulent/negligent transfer be registered it would frustrate the registration of the secured party as a member upon enforcement
- a legal charge of shares for value will rank ahead of a prior equitable charge of shares provided that the legal secured party does not have actual or constructive notice of such prior equitable interest at the time of the creation of the legal charge

In order to mitigate these disadvantages, an equitable charge security package often incorporates the following:

- obtaining the original share certificates representing the charged shares or a confirmation that share certificates have not been issued

- obtaining a signed but undated share transfer form in respect of the charged shares from the chargor
- obtaining an irrevocable power of attorney from the chargor in favour of the secured party
- obtaining a signed but undated letter of resignation from each of the current and future directors of the company whose shares are being charged, together with a signed letter of authority from each such director in favour of the secured party authorising it to date and deliver the letters of resignation upon an event of default
- obtaining a certified copy of the register of mortgages and charges of the chargor (if the chargor is a Cayman company) noting the security interests created by the equitable charge
- requiring a notation to be made in the register of members of the company whose shares are being charged noting that the relevant shares are subject to the equitable charge
- obtaining an irrevocable proxy from the chargor in favour of the secured party so that the secured party can vote the charged shares on behalf of the chargor
- requiring the company whose shares are subject to the equitable charge to amend its articles of association to build in provisions to assist on an enforcement (e.g. removing the directors' discretion to refuse a transfer of shares and/or obliging the directors to transfer the shares to the secured party upon enforcement). The share charge itself would include a requirement that the secured party's consent is required for any subsequent amendments to the articles
- requiring the company whose shares are subject to the equitable charge to provide written instructions to its registered office provider to the effect that if the secured party notifies it that an event of default has occurred it can rely on any instructions from the secured party to register the secured party, or its nominee(s), as the registered holder of the charged shares
- potentially filing a “stop notice” with the Grand Court of the Cayman Islands, which is then served on the company whose shares have been charged. This notice requires that fourteen days prior written notice be given to the secured party before any dealing with the charged shares may be completed

This client briefing is intended to provide a general summary of the position in law as at the date shown above, and is not to be taken as specific legal advice applicable to particular issues or circumstances.

If you would like more information, please contact one of our banking and finance specialists as detailed on this page.

About Ogier

Ogier is a professional services firm with the knowledge and expertise to handle the most demanding and complex transactions and provide expert, efficient and cost-effective services to all our clients. We regularly win awards for the quality of our client service, our work and our people.

Disclaimer

Key Contacts

James Heinicke

Partner

Cayman Islands

E: James.Heinicke@ogier.com

T: +1 345 815 1768

Mark Santangeli

Partner

Cayman Islands

E: mark.santangeli@ogier.com

T: +1 345 815 1766

Thomas Sims

Associate

Cayman Islands

E: thomas.sims@ogier.com

T: +1 345 815 1914

Related Services

Banking and Finance