

Taking security over shares in a Cayman Islands exempted company

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Introduction

One of the major advantages of the Cayman Islands as an international financial centre is that it provides a simple, flexible and robust regime for secured financing transactions that is attractive to lenders.

Share security is a feature of many financing transactions. This guide examines the creation of security over shares in a Cayman Islands exempted company.

Security basics

Unlike certain other leading international financial centres, the Cayman Islands does not have a statutory regime that governs the granting, perfection or enforcement of security over the shares (the **Secured Shares**) in an exempted company incorporated in the Cayman Islands (a **Company**).

As a result, the methods of taking security over Secured Shares derive from English common law.

Under the laws of the Cayman Islands, the *situs* of shares of a Company depends on the location in which its register of members is held. If a Company's register of members is maintained outside of the Cayman Islands then the laws of that foreign jurisdiction may affect how security should be taken over those shares.

Security document

The Companies Act (as amended) (the **Companies Act**) is silent on the requirements for the creation of share security. Nevertheless, the basic requirements are:

- security must be created in writing;
- security document must be signed by the mortgagor or chargor (being the security provider, the **mortgagor**); and
- security must clearly indicate the:
 - intention to create security over the Secured Shares; and
 - amount secured or how that amount is to be calculated.

In practice, the security will typically be created under the terms of a security document in the form of a charge or equitable mortgage.

In addition, the security document should also:

- specify (either directly or by reference to another document) the defaults that entitle the mortgagee or chargee (being the recipient of the security, the **mortgagee**) to enforce the security;
- specify the mortgagee's enforcement powers and remedies;
- include a power of attorney; and
- include the Company as party so that it can undertake to (among other things):
 - ensure that any transfer of the Secured Shares under the security document will be registered immediately on presentation of the signed share transfer form; and

- note the creation of security over the Secured Shares in its register of members.

Stamp duty

No stamp duty is payable on the creation of security over the Secured Shares or any transfer of the Secured Shares on the enforcement of the security unless the security document or any ancillary documents are executed in, or brought into, the Cayman Islands.

Formalities

The security document does not need to be notarised or apostilled.

First steps

Before taking security over the Secured Shares, the mortgagee should:

- inspect the Company's memorandum and articles of association (the **Articles**) to ascertain whether:
 - the Articles afford the Company's directors discretion over registration of transfers;
 - there are any provisions within the Articles that prohibit the creation of security;
 - there are any provisions in the Articles that may hinder or impair the enforcement of the security; and
 - the Company itself has a lien over the Secured Shares for any amounts due from a member of the Company which could take priority over any subsequent security interests;
- inspect the Company's register of members to:
 - ensure that the mortgagor is the registered holder of the Secured Shares;
 - ensure that there is no evidence of any existing security over the Secured Shares; and
 - determine whether the Secured Shares are fully paid.

Regulatory approvals

No regulatory approvals are required to create or enforce security over the Secured Shares unless the Company is a regulated entity in the Cayman Islands.

Governing law of security document

Cayman Islands law permits the security document to be governed by either Cayman Islands law or foreign law.

Cayman Islands law

The security document is most often governed by Cayman Islands law and, as stated above, usually takes the form of an equitable mortgage or a charge. A mortgagee will generally not wish to take a legal mortgage over the Secured Shares to ensure that the mortgagee is not treated as the parent of the Company under the Companies Act and/or to avoid potentially consolidating the Company onto the mortgagee's balance sheet.

Remedies available

If a default occurs under a Cayman Islands law security document, the mortgagee may:

- (subject to the terms of the security document) sell the Secured Shares;
- appoint a receiver in respect of the Secured Shares who may (subject to the terms of the security document):
 - exercise the voting rights attached to the Secured Shares;
 - receive distributions in respect of the Secured Shares; and
 - exercise any other rights and powers of the mortgagor in respect of the Secured Shares.

The mortgagee may exercise the power to sell, and the right to appoint a receiver in respect of the Secured Shares without obtaining a court order.

In addition to the remedies above, if the security is an equitable mortgage, the mortgagee has a right of foreclosure. This remedy extinguishes the mortgagor's right to the Secured Shares but not the mortgagor's

obligation to pay any unpaid sum secured by the security document and can only be exercised by obtaining a court order. This remedy is rarely utilised in practice.

Enforcement

In practice, a mortgagee will typically appoint a receiver to take possession of (and potentially sell) the Secured Shares.

Where a restrictions notice (as defined in the Beneficial Ownership Transparency Act (as amended) (the **BOT Act**)) has been issued with respect to the Secured Shares, the BOT Act provides that where such shares are subject to a pre-existing security interest granted to a third party who is not affiliated with the Company, the restrictions notice shall not take effect.

If the Company is in insolvent liquidation at the time of enforcement, the mortgagee may only transfer the Secured Shares with the prior approval of the Grand Court.

Application of proceeds on enforcement

Unless the security document states otherwise, the proceeds of enforcement of the security will be applied in the following order of priority:

- **first** in paying the enforcement costs;
- **second** in paying the sums secured by the security document; and
- **third** in paying the balance (if any) to the mortgagor.

For more information on the enforcement rights available to a mortgagee, please refer to our guide titled '[Enforcing security over shares in a Cayman Islands exempted company](#)'.

Foreign law

Generally speaking, the mortgagee will prefer to have all transaction documents governed by the laws of a jurisdiction with which the mortgagee is familiar and which are suitable for the transaction. One of the primary advantages of permitting the security document to be governed by foreign law is that it allows the mortgagee greater certainty over the mortgagee's rights, obligations and remedies.

However, it is possible that conflicts of law issues may arise where the security document is governed by a foreign law (eg if the foreign law does not recognise Cayman Islands legal concepts or the converse), so careful consideration should be given to the choice of foreign law. No significant conflict issues are likely to arise where the governing law is New York law, English law, Hong Kong law or the law of another common law jurisdiction.

Security deliverables

The mortgagor will normally be required by the security document or (where relevant) the loan agreement to deliver the following documents to the mortgagee:

- the original share certificates (if any) for the Secured Shares;
- a share transfer form for the Secured Shares signed in blank;
- an irrevocable proxy for the Secured Shares in favour of the mortgagee;
- if the Company is (directly or indirectly) wholly owned by the mortgagor:
 - a signed and undated resignation from each director of the Company; and
 - a letter from each director authorising the mortgagee to date the resignation form and deliver it to the Company if a default occurs under the security document;
- a resolution of the directors of the Company authorising its entry into and execution of the security document;
- a resolution signed by the mortgagor (in its capacity as shareholder of the Company) making any changes to the Company's Articles required by the mortgagee;
- if the mortgagor is a Cayman Islands company, a certified copy of its register of mortgages and charges showing the creation of the security over the Secured Shares (see 'Registrations, notations and filings' below);
- a certified copy of the Company's register of members annotated to show the creation of the security over the Secured Shares (see 'Registrations, notations and filings' below); and

- a notice from the Company's registered office provider under which it:
 - acknowledges the security created over the Secured Shares;
 - undertakes that it will not issue any restrictions notice with respect to the Secured Shares; and
 - undertakes that, once it has received notice from the mortgagee that the security has become enforceable, it will register any transfer of the Secured Shares pursuant to the enforcement of the security.

Registrations, notations and filings

Particulars of security

The Cayman Islands does not maintain a public filing regime, however, where a security interest is created by a Company, it is necessary for the security interest to be recorded in the Company's internal register of mortgages and charges. The Company's register of mortgages and charges must be maintained at its registered office in the Cayman Islands.

There are no express statutory time limits within which a security interest must be recorded in a Company's register of mortgages and charges and a failure to record a security interest will not affect its validity. Similarly, recording a security interest does not create priority. In practice, security interests should be recorded promptly on creation and, preferably, should be updated on the day of closing.

Although a Company's register of mortgages and charges is not a publicly filed document, it is open to inspection by any creditor or member of the Company at all reasonable times.

Articles

If the mortgagee requires any changes to be made to the Articles to facilitate the creation or enforcement of the security, the Company must:

- pass a special resolution to approve the changes to the Articles; and
- forward a copy of the special resolution within fifteen days to the Registrar of Companies in the Cayman Islands.

Preferably, this should be done before the security document is signed. The changes to the Articles will be effective from the time the resolutions are passed.

Register of members

A properly advised mortgagee will require the Company to include in its register of members:

- a statement that security has been created over the Secured Shares;
- the name of the mortgagee; and
- the date on which the statement and mortgagee's name are entered into its register of members.

Although noting the security created over the Secured Shares in the Company's register of members has no technical legal effect, it has the practical effect of putting third parties who view the register on notice of the existence of the security.

Stop notices

If the mortgagee is concerned that any Secured Shares will be transferred in breach of the security document, the mortgagee may apply to the Grand Court of the Cayman Islands for a stop notice.

A stop notice is a notice from the Registrar of the Grand Court to the Company preventing the Company from registering any transfer of the Secured Shares until fourteen days after it has given the mortgagee notice of the proposed transfer.

Contacts

A full list of contacts specialising in Banking and Finance can be found [here](#).