I INTRODUCTION

The transport finance industry in the Cayman Islands

Despite having a small domestic transport market, the Cayman Islands has a high profile in international transport finance transactions, particularly for commercial aircraft and ships. The authors would conservatively estimate that each year in excess of US$4 billion dollars of new aircraft and ship deliveries are financed using Cayman Islands structures.

The Cayman Islands is a popular jurisdiction for structuring such deals for a number of reasons including: (1) offering the political and economic stability of a British overseas territory that has been a leading financial services jurisdiction for several decades; (2) a combined common law and statute-based legal system that reflects many principles of the laws of England and Wales with case law from the English courts being persuasive (although not binding) in the courts of the Cayman Islands; (3) the Cayman Islands currently has no income tax, corporate tax or capital gains tax and no withholding tax is imposed in the Cayman Islands on any cash flows; (4) the Cayman Islands boasts a substantial and sophisticated financial and legal services sector and many professionals in the sector have extensive experience from other leading financial centres; and (5) the Cayman Islands government works closely with the private sector to implement changes to practice and legislation to promote the competitiveness of the jurisdiction in respect of both established and new products. Most financing structures involve a Cayman Islands special purpose vehicle (SPV), typically a Cayman Islands exempted limited company, and this is discussed further below.

In addition to the use of Cayman Islands financing structures for transport assets situated or registered outside the islands, the Cayman Islands is often the preferred state of registry for ships (commercial and yachts) and private aircraft; the respective registers are maintained by government agencies (the Maritime Authority of the Cayman Islands and the Civil Aviation Authority of the Cayman Islands) rather than private entities or private-public enterprises. Each registry has the reputation for being professional, responsive and flexible and providing effective oversight of compliance by registered assets and users with applicable rules and conventions. Major financial institutions and other lenders that participate in aircraft and ship finance for assets registered with these authorities benefit from regulatory oversight to support residual value and a registration system to determine priority of security interests. Other alternative sources of finance are also having an increasing role in the market.
ii Recent changes

The mix of financing products that use Cayman structures changes with the fluctuations in the aviation and shipping markets and broader economic conditions. During the global financial crisis there was a significant increase in export-credit supported financing of asset deliveries. The typical structure for this type of financing uses an ‘orphan’ borrower as described in more detail in Section IV.i, below. As liquidity has returned to the markets the volume of export-credit transactions has significantly reduced.

On the aircraft side, economic recovery has resulted in an increase in capital market transactions including ECA-wrapped bonds, ABS and EETC deals and Cayman Islands SPVs often feature as issuers in such deals. There is a long history of Cayman Islands SPVs acting as issuers in the capital markets with the result that the insolvency considerations and other concepts of Cayman Islands law that are instrumental both to analysis by investors and by the rating agencies are widely understood.

The shipping markets continue to face several challenges, and one of the effects has been that fewer owners are able to obtain finance from traditional ship finance banks. There has been an increase in the use of Cayman Islands orphan SPVs by: (1) banks enforcing bad loans while keeping shipping assets off balance sheet; and (2) Chinese lessors as an alternative source of finance for shipowners.

II LEGISLATIVE FRAMEWORK

The Cayman Islands has its own legal system, which is closely related to that of England and Wales. Decisions of the English courts are of high persuasive authority in the courts of the Cayman Islands. Laws are implemented through the domestic legislative process and may also be enacted by the UK government through the mechanism of an Order in Council.

i Domestic and international law and regulation

Shipping

The Merchant Shipping Law (2016 Revision) of the Cayman Islands (MSL) is the principal legislation for all Cayman Islands-registered vessels and although primarily based on the corresponding law of England and Wales it has been adapted for the Cayman Islands. The MSL sets out the categories of qualified persons who may own a ship registered in the Cayman Islands and also provides for several different kinds of registration available including full registration, interim registration, provisional registration, ship-under-construction registration (which can then be converted to a full registration on delivery) and demise charter or bareboat registration. The MSL provides for the registration of mortgages over completed vessels, mortgages over vessels under construction, and the ability to record a priority notice giving an intending mortgagee priority over later registered mortgages.

The international conventions that have been extended to or otherwise been introduced by domestic law in the Cayman Islands include:

a Load Line (International Convention on Load Lines 1966, as amended by the Protocol of 1988);
b Tonnage (International Convention on Tonnage Measurement of Ships 1969);
c MARPOL (International Convention for the Prevention of Pollution from Ships 1973 and 1978 Protocol);
d SOLAS (International Convention on the Safety of Life at Sea 1974 and 1978);
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STCW (International Convention on Standards of Training, Certification and Watchkeeping for Seafarers 1978);

COLREG (Convention on the International Regulations for Preventing Collisions at Sea 1972 as amended);

Maritime Labour Convention 2006; and


Aircraft

Oversight of civil aviation throughout the Cayman Islands and of aircraft registered in the Cayman Islands is carried out by the Civil Aviation Authority of the Cayman Islands (CAACI). The CAACI operates in accordance with the Air Navigation (Overseas Territories) Order 2013 (as amended) (ANOTO), which was enacted in the United Kingdom and extended to the Cayman Islands as a British overseas territory. ANOTO, the Overseas Territories Aviation Regulations and certain other aviation-related legislation and regulations set out requirements for the registration, operation and continuing airworthiness of aircraft registered in the Cayman Islands. ANOTO is primarily concerned with air safety, aircraft registration and the implementation in the overseas territories of the United Kingdom's obligations under the Chicago Convention. ANOTO also sets out the categories of qualified persons who may hold a legal or beneficial interest by way of ownership in an aircraft registered in the Cayman Islands.

The Mortgaging of Aircraft Regulations 2015 provide for the recording of aircraft mortgages over Cayman-registered aircraft on the register of aircraft mortgages maintained by the CAACI. Priority of these mortgages is generally determined by the order in which a mortgage is registered. It is also possible to file a priority notice with the CAACI to preserve a prospective mortgagee's priority position pending the anticipated execution and registration of a mortgage.

A new development for the Cayman Islands is that the Convention on International Interests in Mobile Equipment concluded in Cape Town, South Africa on 16 November 2001 (the Convention) and the Protocol to the Convention on Matters Specific to Aircraft Equipment (the Protocol) (the Convention and the Protocol together, the Cape Town Convention) came into force in the Cayman Islands on 1 November 2015 pursuant to the International Interests in Mobile Equipment (Cape Town Convention) Law, 2015 (the CTC Law). The CTC Law sets out the declarations under the Cape Town Convention that apply with respect to the extension by the United Kingdom of the Cape Town Convention to the Cayman Islands (as a territorial unit of the United Kingdom). No declaration has been made with respect to Article 60(1) of the Convention and, as a result, the Cape Town Convention and the CTC Law do not apply to pre-existing rights or interests, which retain the priority enjoyed prior to 1 November 2015.

As part of the process of implementing the Cape Town Convention in the Cayman Islands, certain other legislative changes and updates have been made including replacement of the Mortgaging of Aircraft Regulations 1979 with the Mortgaging of Aircraft Regulations 2015, amendment of ANOTO and enactment of the Civil Aviation Authority Law (2015 Revision) and the Bills of Sale (Amendment) Law 2015.

Specific practices

The recent implementation of the Cape Town Convention means that there is no settled practice as to whether a mortgage over a Cayman-registered aircraft should be registered
on the register of aircraft mortgages maintained by the CAACI in addition to registering the associated international interest on the International Registry. There is also currently no reported case law in the Cayman Islands with respect to the interpretation and applicability of the Cape Town Convention.

III  FINANCIAL REGULATION

The Cayman Islands Monetary Authority (CIMA) is responsible for licensing and regulating banking business in the Cayman Islands and the Banks and Trust Companies Law (the 2013 Revision) provides the legal framework for the operation of banks in the Cayman Islands. A bank carrying on business in the Cayman Islands and lending to the transport sector is required to comply with the Law and would be subject to CIMA oversight.

i  Regulatory capital and liquidity and supervisory regime

The 2013 Revision sets out minimum net worth thresholds for banks that vary according to the type of banking licence held. That Law stipulates that a bank incorporated in the Cayman Islands must have a capital adequacy ratio (risk asset ratio) of no less than 10 per cent or such other percentage as may be determined by the CIMA. Capital adequacy concepts including the capital structure and classification and risk-weighting of asset types are determined by the CIMA. The authority currently requires subsidiaries of foreign banks that are subject to consolidated supervision to maintain a minimum capital adequacy ratio of 12 per cent and locally incorporated banks to maintain a minimum capital adequacy ratio of 15 per cent. Banks are also required to comply with limits prescribed by the CIMA (calculated by reference to a bank’s capital base) with respect to certain other matters including large exposures and credit risk concentration.

IV  SECURITY AND ENFORCEMENT

i  Financing of contracts

Cayman Islands structures are frequently used for the financing of pre-delivery payments for new aircraft and vessels. The typical structure is substantially the same as the orphan structure described in Section IV.i, below, save that the security package customarily includes an arrangement between the lender and the manufacturer pursuant to which the lender can purchase the asset (in lieu of the original customer) if the customer is in default.

Typical ship finance structure

A typical structure (whether the vessel is registered in the Cayman Islands or elsewhere) involves a Cayman SPV being used as the vehicle to acquire the vessel. The SPV will enter into a credit facility as borrower and the advances it receives are applied to finance its acquisition of the vessel. The SPV will then make the vessel available for charter and the charter income is used by the SPV to pay interest and repay principal under the credit facility. There are no taxes imposed in the Cayman Islands with respect to the charter income received by the SPV or on the payment by the SPV to the financing parties of the interest and principal. The lender will usually take security over the vessel (if the vessel is registered in the Cayman Islands then a statutory mortgage would usually be registered at the Cayman Islands Shipping Registry (CISR)) and over the issued share capital of the SPV itself. An assignment by the SPV to
the lender of vessel insurances, earnings, requisition compensation and its rights under any
charter will also give the lender effective control of the enforcement of rights of the SPV as
against relevant third parties, including, in particular, any charterer of the vessel. An orphan
structure is often used and this is discussed further in the section on aircraft structures below.

**Typical aircraft finance structure**

Similar to a vessel finance transaction, the typical structure involves a Cayman SPV acting
as borrower and owner to acquire the aircraft, receive advances from a lender and lease the
aircraft to the airline or other operator. The lender will usually take security over the aircraft,
over the SPV’s rights under the lease and under manufacturer warranty agreements, and over
the issued share capital of the SPV itself.

With respect to aircraft registered in the Cayman Islands, the registered owner of the
aircraft will typically be either a Cayman Islands exempted company incorporated with
limited liability or a company incorporated in another qualifying jurisdiction whose shares
are held by the beneficial or ultimate owner of the aircraft. It should also be noted that the
Cayman Aircraft Register is not an owner registry; a registered owner (who must fall within
one of the categories of qualifying persons) may be a ‘charterer by demise’ (for example, a
lessee under a lease). A lender will typically take security over the aircraft in the form of an
aircraft mortgage (which can be registered in the Register of Aircraft Mortgages maintained
by the CAACI). Further, a suite of self-help documents such as a deregistration power of
attorney from the registered owner, a beneficial-owner consent from the ultimate owner of
the aircraft and an Irrevocable Deregistration and Export Request Authorisation in most
cases will be provided to the lender and lodged with the CAACI. There is no prescribed form
of mortgage and it can be, and typically is, governed by foreign law.

For both aircraft and vessel financing, an orphan structure is often used in which the
shares of the borrower SPV are held by a share trustee. From the perspective of the lender
this structure may provide certain advantages including protection from the consequences of
the vessel or aircraft operator becoming insolvent (neither the SPV nor the vessel or aircraft
would be an asset of the insolvent party) and bankruptcy remoteness (if the lender is the only
material creditor of the SPV).

Except to note that a vessel mortgage may be registered with the CISR and an aircraft
mortgage may be registered with the CAACI, there is no central security register in the
Cayman Islands and, accordingly, no filings are required to perfect a security interest.

**ii Enforcement**

The Cayman courts will recognise and enforce foreign law-governed contractual and security
arrangements provided the arrangements are enforceable under the applicable foreign law.
Relevant government agencies and other parties will also cooperate with the exercise of any
self-help remedies available to a transaction party; for example, the cancellation of an aircraft
registration pursuant to a deregistration power of attorney or a transfer of shares pursuant to
a pre-signed share transfer form in respect of shares in an SPV.

With respect to Cayman Islands registered vessels, in the event it becomes necessary for
a secured lender to exercise its rights under a vessel mortgage, the Merchant Shipping Law
contains a statutory power of sale.

With respect to aircraft registered in the Cayman Islands, although legal proceedings
relating to locally registered aircraft and aircraft mortgages are rare, the Cayman Islands
courts are able to deal competently and effectively with claims that may arise. As a practical
matter, if the aircraft or other relevant property is located at an airport in the Cayman Islands, then permission would be needed from the Cayman Islands Airport Authority to enter that location and take physical possession of the aircraft or property.

iii Arrest and judicial sale

The procedure for enforcement of interests under Cayman Islands law, while governed by local rules, is similar to the procedure followed in the courts of England and Wales.

 Proceedings in respect of ship arrest are brought in the Admiralty Division of the Grand Court (the Court) and allocated to a designated Admiralty judge. Once a writ has been issued, any party to the action may apply for a warrant of arrest to the Clerk of the Court on affidavit setting out the nature of the claim (or counterclaim), verifying that it has not been satisfied and identifying the vessel and its home port. The onus is on the party seeking the warrant to conduct searches to ensure that no caveat against arrest has been lodged, and there are diplomatic formalities to be complied with where the ship is a foreign ship of a state with a consulate in London, or where any treaty exists with the relevant state in respect of ship arrest.

 Service of a warrant of arrest, which is valid for 12 months after the date of issue, is effected by affixing the writ for a short time to the mast or any suitable part of the superstructure, and on removal leaving a copy affixed on a sheltered, conspicuous part of the ship. Warrants are executed by the bailiff, subject to an undertaking from the relevant party to pay on demand their fees and expenses. Thereafter, the bailiff is able to apply for directions in respect of the property under arrest, as may any other person concerned.

 In cases of wrongful arrest, on application by the aggrieved party the Court may not only discharge the warrant but also order the payment of damages in respect of any losses sustained by reason of the arrest.

 As there is no provision in Cayman Islands law extending the jurisdiction of the Admiralty Division over matters concerning aircraft, it is unlikely that the judicial arrest procedure will be available in such cases. However, the Court has a broad and well-developed power to grant freezing injunctions applicable both within and outside the jurisdiction that is arguably more appropriate in respect of aircraft and capable of prohibiting both disposal and movement.

 In terms of the process for sale, the Cayman Islands is a creditor-friendly jurisdiction that will commonly recognise and enforce contractual and security arrangements, provided those have been validly created under the applicable national law. Where the arrangements make provision for self-help remedies, those will generally be enforceable without the need for any separate court order authorising these steps, and in this regard (as discussed in Section II.i, supra), the Cayman Islands have enacted the provisions of the Cape Town Convention into domestic law, including Article 8 relating to the sale and seizure of charged objects.

 Where court intervention is required, the process for obtaining an order for sale of charged property is relatively streamlined, involving a short application before a judge supported by an affidavit, and may be coupled with the appointment of a receiver over the property in an appropriate case. Security interests in respect of registered ship mortgages may be enforced in the same way as interests over any other personal property, subject to the ordinary duty of the chargee to obtain the best price reasonably possible. For the avoidance of doubt, foreclosure, although technically available, is rarely utilised by the Cayman Islands courts and for practical purposes security interests will ordinarily be realised by way of sale.
V CURRENT DEVELOPMENTS

i Recent cases
The recent decision of the English Court of Appeal in *PK Airfinance SARL & Anor v. Alpstream AG & Ors* is likely to be highly persuasive in analogous cases before the Cayman courts. The case offers significant guidance to secured parties wishing to obtain ‘ownership’ of aircraft in which they hold security interests upon enforcement of those security interests. Key points covered by the case include (1) a ‘sale’ by a secured party to itself would be void, but a sale to a connected party (for example to a group entity) may be possible, notwithstanding that such a process might give rise to a conflict; (2) where such a conflict exists, the burden of proof will rest with the secured party to establish that the transaction was in good faith and that reasonable precautions were taken to obtain the best price at the time of the sale, and (3) where a secured party cannot demonstrate these matters, the courts will as a general rule set the transaction aside or, if inequitable to do so, order damages.

ii Developments in policy and legislation
On 8 July 2016, the Limited Liability Companies Law 2016 came into force. The Limited Liability Companies Law 2016 provides for the incorporation of a new form of Cayman Islands vehicle, the exempted limited liability company (ELLC). The law is similar to the Delaware LLC law and an ELLC is considered to be similar to a Delaware LLC, being a body corporate with separate legal personality. It is hoped that the similarity will encourage investors and lenders that are accustomed to working with Delaware LLCs to consider the ELLC as a viable alternative when structuring transactions.

iii Trends and outlook for the future
The Cayman Islands should remain a popular jurisdiction for structuring finance transactions for aircraft, vessels and other types of movable asset wherever situated. The implementation of the Cape Town Convention in the Cayman Islands is a positive development for the jurisdiction, enabling the Cayman Islands to keep pace with other jurisdictions used for aircraft finance structures that are already contracting states to the Convention.

The Cayman Islands government supports the development of a maritime cluster in the Cayman Islands and has recently created the Cayman Maritime Services Park within the Cayman Enterprise City (a special economic zone within the Cayman Islands designed to facilitate foreign investment). The ongoing focus by the government on the maritime sector is expected to increase the profile of the Cayman Islands within the shipping industry.

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Richard Munden is based in Walkers’ Cayman Islands office, where he is a partner in the firm’s global finance and corporate group. He advises on a broad range of finance and corporate matters and specialises in aircraft, shipping and other asset finance, acting for lenders, leasing companies, manufacturers, export credit agencies and operators. Richard also advises on financing for hedge funds, private equity funds and venture capital funds and advises with respect to downstream acquisitions and other transactions. His corporate practice covers share acquisitions and sales, equity issues and joint venture and shareholder arrangements across a wide range of industry sectors.

Prior to joining Walkers, Richard was general counsel and part of the early stage management team of Vueling Airlines in Barcelona. After the IPO of the airline, he was appointed head of fleet. While in-house, Richard worked on a range of commercial projects and was heavily involved in the aircraft finance and leasing market, leading his airline’s fleet acquisition programme and manufacturer negotiations.

Before his in-house role, Richard was part of the finance group at Freshfields Bruckhaus Deringer in London and Madrid. He specialised in cross-border asset finance, bilateral and syndicated lending and project finance for clients including banks, airlines, leasing companies and other large corporates.

NICK DUNNE

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Nick Dunne joined the Walkers Cayman Islands office in 2008. He is senior counsel in the firm’s commercial litigation and dispute resolution group. He deals with a wide range of local, international and cross-border commercial disputes and arbitrations, with a particular expertise in asset recovery. He is described in the 2015 edition of Who’s Who Legal as a ‘regular on the asset-recovery scene’ and frequently appears in cases before both the Grand Court and the Cayman Islands Court of Appeal, with experience of appeals to the Judicial Committee of the Privy Council.

He is also a member of the regulatory group, with significant practical experience of local licensing and approvals for financial services, aviation and technology operations.

Nick was called to the Bar by Middle Temple in 2001 and was a barrister in private practice until he relocated to the Cayman Islands.

EDWARD RHIND

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Edward Rhind joined the Walkers Cayman Islands office in 2016, where he is an associate in the firm’s corporate and finance group. He acts on a range of finance and commercial matters for clients including banks, shipowners, airlines, leasing companies, operators and funds, and specialises in asset and structured finance. Edward has particular experience with ship finance, and offshore vessel and equipment finance, as well as yacht finance, sale and purchase, shipbuilding contracts and restructurings. Having been based in Asia, Europe and the Caribbean, Edward has experience of a wide range of transactions.
Prior to joining Walkers, Edward worked in the ship finance team of Stephenson Harwood LLP in Singapore and London.