

Cayman Islands exempted companies - Directors' duties and liabilities

GUIDE

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Introduction

It is important that directors of Cayman Islands exempted companies understand their duties and liabilities under Cayman Islands law, which arise from:

- **the common law:** these duties have developed over time by way of analogy with other legal relationships, particularly the relationship between principal and agent and between trustee and beneficiary;
- **statute:** principally the Companies Act (2023 Revision) (the **Companies Act**), but also the Penal Code (2024 Revision), the Proceeds of Crime Act (2024 Revision) and, where appropriate, the Mutual Funds Act (2021 Revision) and the Private Funds Act (2021 Revision) (each as amended); and
- **the memorandum and articles of association of the company:** its constitution, within the limits of which the directors are obliged to operate.

To whom are directors' duties owed?

In general, directors owe duties to the company as a whole. This means that the directors must consider the interests of the current and future shareholders of the company. Where a company is insolvent, or of doubtful solvency, the directors have a duty to consider the interests of the company's creditors as paramount. This is because the creditors are the ultimate beneficiaries of an insolvent company's assets.

Who may sue for breach of duty?

Since directors owe their duties to the company, generally only the company may bring an action against a director alleging a breach of duty. This is because the alleged wrong will have been done to the company.

However, under the common law, if the company will not bring an action against a director alleging a breach of duty, a shareholder may bring an action (called a derivative action) against the director on behalf of the company and in the company's name. Mourant can advise on derivative actions which may be taken by the shareholders.

Common law duties and liabilities

Under the common law, directors owe fiduciary duties and a duty to exercise skill and care.

Fiduciary duties

A director must act in good faith in the director's dealings with or on behalf of the company and exercise the powers and fulfil the duties of the director's office honestly. A director's fiduciary duties include the following aspects:

- a duty to act in good faith in what the director considers are the best interests of the company;
- a duty to exercise powers in the company's interests and only for the purpose or purposes for which they are given;
- a duty to avoid any conflict of interest (whether actual or potential) between the director's duty to the company and the director's personal interests or a duty owed to a third party;
- a duty not to improperly fetter the exercise of the director's future discretion; and
- a duty not to misuse the company's property (including any confidential information and trade secrets).

Duty to exercise skill and care

When a director is acting in the company's interests, the director is expected to exercise appropriate skill and care. The relevant threshold is that of:

A reasonable diligent person having both – (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and (b) the general knowledge, skill and experience that that director has.

This duty has two aspects:

- a duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable the director to properly discharge his duties; and
- a duty to attend diligently to the affairs of the company.

Whilst directors are entitled (subject to a company's articles of association) to delegate particular functions and to trust the delegates' competence and integrity to a reasonable extent, the exercise of that power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.

If a director breaches his fiduciary duties or duties of skill and care, he may be personally liable to the company for damages.

Other instances of personal liability

A director may be personally liable under the common law for offences of negligent misstatement, deceit or misfeasant trading.

Negligent misstatement

Where a director has been negligent in making a statement, the director may be liable under a claim for damages brought by a plaintiff who has suffered loss through acting in reliance on that statement. In connection with funds, each director should read the offering document as it progresses to final proof. Each director should consider every material statement of fact or of opinion contained in such offering document and be satisfied, prior to publication of the document, that:

- the director is not aware of anything which would cause the director to doubt the accuracy of any statement in the document; and
- each statement has been the subject of sufficient verification by appropriate and competent people to afford the director reasonable grounds to believe that it is true and not misleading.

Deceit

If a director has made a false statement, either with knowledge of its falsity or being reckless as to whether it is true or false, the director could be liable for damages to a person (including, but not limited to a shareholder or investor) thereby deceived. The measure of damages in an action for deceit is the actual damage suffered by the plaintiff, including consequential loss and it is not limited to damages which are reasonably foreseeable as a result of the deceit.

Insolvency deepening activities

A recent decision¹ in the English Courts means that, under common law, directors could be held liable for continuing to trade when there is a risk of insolvency and of their activities prejudicing creditors. Where there is such a risk, it is important for directors to obtain proper professional advice, act on that advice, ensure due consideration is given to the interests of creditors and carefully consider whether the company should be placed into liquidation rather than continuing to trade.

Directors need to exercise particular care in allowing the company to continue to trade in these circumstances. This is not least because failing to consider matters properly may prevent directors from relying on any indemnities in their favour contained in the company's constitutional documents, and the potential liabilities may considerably exceed the amount of any directors and officers' (D&O) insurance in place.

¹ In *Wright & Ors v Chappell & Ors (Re BHS Group Ltd & Ors (in liquidation))* [2024] EWHC 1417 (Ch) damages were awarded against directors for 'misfeasant trading', in that they acted for an improper purpose and breached their duty to have regard to the interests of creditors.

Statutory obligations and liabilities

The general principles governing a director's conduct set out above are enhanced by a range of specific duties imposed by statute.

The Companies Act

The Companies Act places certain duties upon the directors of Cayman Islands exempted companies, some of which are sanctioned by criminal penalties. Many of these duties are specifically imposed upon the directors. The Companies Act does not make any distinction between executive and non-executive directors.

Where a company is in breach of certain statutory obligations, any officer or director of the company who knowingly and wilfully authorised or permitted the breach will also be liable to a penalty. The key statutory provisions that are sanctioned in this way include:

- **Distributions out of share premium account:** No distribution or dividend may be paid to members out of the share premium account unless immediately thereafter the company is able to pay its debts as they fall due in the ordinary course of business. A company and any director who knowingly and wilfully authorises or permits a breach is guilty of an offence and liable on summary conviction to a fine of US\$18,295 and to imprisonment for five years.
- **Redemption and purchase of shares:** A payment out of capital by a company for the redemption or purchase of its own shares is not lawful unless immediately thereafter, the company shall be able to pay its debts as they fall due in the ordinary course of business. A company and any director who knowingly and wilfully authorises or permits a breach is guilty of an offence and liable on summary conviction to a fine of US\$18,295 and to imprisonment for five years.
- **Registers:**
 - Every exempted company must keep a **register of members** and may keep this register at any location. Failure to comply will incur a penalty of US\$6,100. The same penalty will apply to any director of the exempted company who knowingly and wilfully authorises the breach.
 - Every exempted company must maintain at its registered office a **register of all mortgages and charges** over the property of the company. Failure to comply will incur a penalty of US\$610. Where the breach has been knowingly or wilfully authorised or permitted, the exempted company and its directors will incur a further penalty of US\$1,220, with an additional penalty of US\$122 for every day the breach continues.
 - Every exempted company shall keep at its registered office a **register of directors and officers** (including alternate directors). A copy must be sent to the Registrar with any changes to be notified within 30 days. Failure to comply will incur a penalty of US\$610. Where the breach has been knowingly or wilfully authorised or permitted, the exempted company and its directors will incur a further penalty of US\$1,220, with an additional penalty of US\$122 for every day the breach continues.
- An exempted company must provide the Registrar with a **declaration** each year confirming that there has been no change to the memorandum of association (other than for company name or a change already reported) and that the company's operations have continued to be mainly outside the Cayman Islands. Every director and officer who knowingly makes or permits a false declaration, is guilty of an offence and liable on summary conviction to a fine of US\$6,100 and to imprisonment for one year.
- An exempted company shall not trade in the Cayman Islands with any person, firm or corporation except in furtherance of its business carried on outside the Cayman Islands. Without prejudice to any other proceedings, the company and every director, provisional director and officer who breaches this requirement is guilty of an offence and liable on summary conviction to a fine of US\$122 for every day it continues. The company is also liable to be immediately dissolved and removed from the register.
- **Segregated portfolio companies:** Additional duties and liabilities are imposed on directors of segregated portfolio companies. Please refer to our guide on '[Cayman Islands Segregated Portfolio Companies](#)' for further details.

The Penal Code

The Penal Code (2024 Revision) contains a number of offences for which directors may be liable, and should be aware of, including the following:

- **false statements by directors:** an officer of a body corporate or unincorporated association (or person purporting to act as such) who, with intent to deceive members or creditors of the body corporate or association about its affairs, publishes or concurs in publishing a written statement or account which to their knowledge is or may be misleading, false or deceptive in a material particular, is guilty of an offence and liable to imprisonment for seven years;
- a director may also commit an offence where any of the following offences is committed by a body corporate with that director's consent or connivance:
 - **obtaining property by deception:** dishonestly obtaining property belonging to another by deception with an intention of permanently depriving the other of it (liable to imprisonment for ten years);
 - **obtaining pecuniary advantage by deception:** dishonestly obtaining for itself or another any pecuniary advantage (liable to imprisonment for five years); and
 - **false accounting:** dishonestly (with a view to gain for itself or another or with intent to cause loss to another) destroying, defacing, concealing or falsifying any accounting record, or, in furnishing information for any purpose, producing or making use of any accounting record, which to its knowledge is or may be misleading, false or deceptive (liable to imprisonment for seven years).

The Proceeds of Crime Act

The Proceeds of Crime Act (2024 Revision) (as amended) contains a number of money laundering offences of which directors should be aware. Some of the key relevant offences, the penalty for which is a fine and/or imprisonment, include the following:

- a person is guilty of an offence if that person conceals, disguises, converts or transfers criminal property, or removes criminal property from the Cayman Islands;
- a person is guilty of an offence if that person enters into or becomes concerned in an arrangement which that person knows or suspects facilitates (by whatever means) the acquisition, retention, use or control of criminal property by or on behalf of another person; and
- a person is guilty of an offence if that person acquires, uses or has possession of criminal property.

In connection with regulated funds, it is important that directors put in place appropriate procedures to allow the administrators on behalf of the company to ascertain the identity of the subscribers to the shares and the source of funds. Satisfactory references should be obtained regarding the intended beneficial owners of the shares from a recognised professional firm or financial institution such as a bank, a law firm or an accounting firm. If a subscription application is received from a professional intermediary, the company should obtain a written agreement from the intermediary that it has verified the identity and carried out a due diligence check in respect of the intended beneficial owner.

The Mutual Funds Act

The Mutual Funds Act (2021 Revision) (as amended, the **MFA**) imposes certain duties on a regulated mutual fund and its directors, some of which are sanctioned by criminal penalties, including:

- **Licensing and regulatory requirements:** it is the responsibility of the directors to ensure that a mutual fund is carrying on its business in accordance with the licensing and regulatory requirements of the MFA. Failure to do so is an offence and liable on conviction to a fine of US\$121,950.
- **Disclosure:** an offering document in respect of equity interests in a mutual fund must be filed with CIMA (unless otherwise exempted) and describe the equity interests in all material respects, and contain such other information as is necessary to enable a prospective investor in the mutual fund to make an informed decision as to whether or not to subscribe for or purchase the equity interests. Such information must be updated within 21 days of any material change. The directors are responsible for ensuring that the company complies with this provision. Failure to do so is an offence and liable on conviction to a fine of US\$121,950. This duty supplements any duty of disclosure under common law or any other law.

- **Audited accounts:** a regulated mutual fund must have its accounts audited annually by a CIMA-approved auditor and sent to CIMA within six months of the financial year end (or within such extension period as CIMA may allow). The directors are responsible for ensuring that the company complies with this provision. Failure to do so is an offence and liable on conviction to a fine of US\$24,390.
- **Information requested by CIMA:** if CIMA has reasonable grounds for believing a person is carrying on or attempting to carry on business as a mutual fund in or from the Cayman Islands without a licence or registration, CIMA may instruct that person to provide such information or explanation as may be reasonably required to enable CIMA to carry out its duty under the law. A person (including a director) who fails to comply is guilty of an offence and liable on conviction to a fine of US\$121,950. Furthermore, a person providing such information, that they know or should reasonably know is false or misleading, is guilty of an offence and liable on conviction to a fine of US\$121,950.

In general, CIMA has broad powers to ensure the protection of investors and creditors and to ensure that the direction and management of the fund is being conducted in a fit and proper manner, including requiring the substitution of a director.

Directors of regulated mutual funds under the MFA are subject to the registration and licensing requirements under the Directors Registration and Licensing Act, 2014 (as amended, the **DRLA**). Please refer to our guide on '[The Director Registration and Licensing Regime in the Cayman Islands](#)' for further details.

The Private Funds Act

The Private Funds Act (2021 Revision) (the **PFA**) also places certain duties upon private funds and, where the fund is a company, its directors. In particular, it is the responsibility of the directors to ensure that a private fund is in compliance with the PFA. Failure to do so will lead to the commission of an offence and liability on conviction to a fine of US\$24,390.

Directors of registered private funds do not have to register under the DRLA.

The administrative fines regime

Pursuant to the Monetary Authority (Administrative Fines) Regulations (2022 Revision), CIMA has the power to impose administrative fines on regulated funds in respect of breaches of certain provisions under the MFA, the PFA and other Cayman Islands laws, regulations and regulatory measures. These administrative fines are in addition to any penalties which may be imposed under the MFA and the PFA. Please refer to our guide '[The Cayman Islands administrative fines regime](#)' for further details.

Shadow directors

Under Part V of the Companies Act in relation to the winding up of companies, a 'shadow director' is defined as 'any person in accordance with whose directions or instructions the directors of the company are accustomed to act', except for someone who is giving advice to the directors in a professional capacity. As with directors, a shadow director may be liable for certain offences relating to the winding up of a company under the Companies Act, including fraud in anticipation of winding up, misconduct in the course of winding up, and material omissions in any statement relating to the company's affairs. Each is a criminal offence liable to a fine and/or imprisonment for a term of five years.

Regulatory measures²

CIMA's Rule on Corporate Governance for Regulated Entities and Statement of Guidance on Corporate Governance for Mutual Funds and Private Funds (together, the **Corporate Governance Measures**) establish key principles of good governance which must be observed by regulated mutual and private funds. The principles require among other things, that the board of directors attend to the following matters in a manner which is commensurate with the size, complexity, structure, nature of business and risk profile of the fund's operations:

² <https://www.cima.ky/investment-funds-regulatory-measures>

- establish, implement and maintain a corporate governance framework;
- properly oversee the activities and affairs of the regulated fund and its service providers;
- adhere to the individual and collective duties prescribed by the Corporate Governance Measures;
- suitably identify, disclose, monitor and manage all conflicts of interest on an annual basis;
- appropriately manage and mitigate the fund's risks;
- hold regular meetings, at least annually; and
- maintain internal documents which fully record the proceedings of meetings of the board of directors and/or other determinations.

CIMA's Rule and Statement of Guidance on Internal Controls (the **Internal Controls Rule**) applies to all regulated entities (including regulated funds) and, as with the Corporate Governance Measures above, should be addressed in a manner which is proportionate to the size, complexity, structure, nature of business and risk profile of the fund's operations. The Internal Controls Rule places duties on the directors to (among other things):

- ensure that an adequate and effective system of internal control is established, documented and maintained;
- approve and periodically review the overall business strategies and significant policies of the regulated entity;
- understand the material risks faced by the regulated entity;
- approve the organisational structure and ensure that senior management is monitoring the effectiveness of the internal control system; and
- demonstrate independence from senior management and exercise oversight of the development and performance of internal controls (where this is not reasonably possible, policies and procedures must be in place to identify and manage actual or perceived conflicts of interests).

Memorandum and articles of association

A company's memorandum and articles of association will typically place a number of duties on directors, including duties to disclose interests, observe procedural requirements relating to meetings, maintain records and registers, ensure that the company's borrowings do not exceed a set amount and/or obtain consent from shareholders before taking particular actions.

If the directors exceed their powers under the memorandum or articles of association, they will be in breach of their common law and statutory duties, and consequently, be potentially liable to compensate the company for any loss suffered by it as a result.

Relief from liability

The Companies Act does not contain any provision to allow a court to relieve a director from liability for a breach of duty. Nor does it contain any provision to give shareholders the power to authorise or ratify an act of the directors that may otherwise amount to a breach of duty. However, under common law, the shareholders may, by a majority, authorise or ratify an act of the directors that may otherwise amount to a breach of duty if all material facts are disclosed to them. Where the shareholders do so, the directors will be released from any personal liability to the company. The shareholders do not have the power to authorise or ratify an act that involves illegality, fraud, dishonesty or the misappropriation of company property.

Protections against directors' liability

Indemnity from company

A company may include a provision in its articles of association or may enter into a separate contractual arrangement with a director to indemnify a director in certain circumstances, provided that such indemnification cannot override certain core fiduciary duties, such as to exclude liability where the director has acted fraudulently, dishonestly, or in wilful default of his or her duties. While indemnity provisions which are

included in a company's articles of association *may* be impliedly (if not expressly) incorporated into the separate contractual arrangement with a director, to avoid a later dispute about whether such provisions were or were not so incorporated, it is ordinarily better to ensure that the equivalent indemnity provisions are expressly included in a separate contract with the director (eg, director's service contract).

Insurance

A company may also purchase and maintain insurance for directors and certain other persons against liability incurred as a result of any negligence, default, breach of duty or breach of trust in relation to the company. Ideally, a director should seek to have both an indemnity from the company and a directors and officers liability insurance policy (**D&O liability insurance**) as:

- an indemnity will be worthless if the company is unable to pay a claim, which could occur if the company were to become insolvent;
- D&O liability insurance may cover liabilities for which the company is unable to indemnify the director; and
- claiming under D&O liability insurance may avoid protracted litigation.

Taking out D&O liability insurance is also beneficial from the company's perspective because it will not have to pay out under a director's indemnity if the liability is covered by the insurance policy.

Practical steps to guard against personal liability

It is not possible to provide exhaustive guidance on the actions that directors should take to ensure they fulfil their duties and guard against personal liability. Nonetheless, a director should always seek to:

- be familiar with the company's memorandum and articles of association;
- take any action necessary to ensure that the director is aware of, and understands, the company's business;
- actively participate in, or supervise and direct, the conduct of the company's business;
- attend all board meetings, and where this is not possible, read any board papers and discuss the agenda items with the chairperson before and after the meeting or appoint an alternate to attend the meeting;
- read all financial statements, reports and papers sent to the directors;
- ensure that adequate internal controls and risk management procedures are put in place and followed;
- regularly monitor the financial position of the company and ensure that accurate minutes are kept of all meetings of directors and shareholders;
- ensure that the company has competent management in place and actively engage with and (where necessary) scrutinise management;
- monitor the activities of any person or committee to whom the directors have delegated any of their powers (eg, by requiring regular reports);
- avoid any conflict of interests, and where a potential conflict of interest does arise, promptly notify the other directors;
- get an indemnity from the company that is set out in the director's service contract or letter of appointment or in a deed of indemnity; and
- ensure that the company keeps D&O liability insurance in place that covers the liabilities that are relevant to the business carried on by the company.

Contacts

A full list of contacts specialising in Cayman Islands law can be found [here](#).