PANORAMIC

FUND FINANCE

Cayman Islands

LEXOLOGY

Fund Finance

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STRUCTURE AND PURPOSE OF FUND FINANCINGS

Financing structures

What types of financing structures are common in your jurisdiction? Are other types of credit facilities available for funds? What are the purposes of each (eg, management fee facilities, general partner financings)?

Cayman Islands entities are commonly used across all levels of the fund structure. Given the commercial flexibility of Cayman Islands entities, we see a broad spectrum of fund finance products being used, on equivalent terms to other jurisdictions, and there are no limits or restrictions imposed by Cayman Islands law on the use of such products generally.

Subscription facilities are the most common given their long-established history in the market and comfort of use by both fund managers and investors. More recently, there has been a significant increase in the use of net asset value (NAV) facilities and, to an extent, hybrid facilities (a combination of subscription line and NAV) that offer financing for the full life cycle of a fund. Fund managers also look to use management fee or GP facilities to bridge the funding gap between fund managers and their contribution to the fund in question. Again, their use is broadly equivalent to other jurisdictions, and market participants should expect to find Cayman Islands law to be flexible, modern and well-suited to all types of fund finance products currently used in the market.

Law stated - 10 January 2024

Fund structure

What does a typical fund structure look like and where might different types of financing sit in a typical fund structure? How are the various entities within a fund group structured? Are financing techniques used as a fund-raising vehicle in your jurisdiction?

Entities formed in the Cayman Islands can be found at all levels in a fund structure. Typically, at the investor-facing level, exempted limited partnerships (ELPs) are utilised. ELPs are often used alongside limited partnerships in other jurisdictions (such as Delaware or Luxembourg). The partnership agreement used for entities in other jurisdictions can usually be adapted for use by an ELP with relatively few changes in order to ensure commercial consistency for fund managers and investors alike.

For subscription facilities, it is common for borrowings to be incurred at the master fund level, with feeder fund vehicles, alternative investment vehicles and/or parallel fund vehicles providing credit support by way of guarantees and/or security over capital-call commitments and, if applicable, bank accounts.

For net asset value facilities, borrowing might occur at the master fund level or below in a portfolio company holding vehicle or other intermediary entity. Cayman Islands law offers significant flexibility equivalent to other popular fund formation jurisdictions and, therefore, fund managers should expect to be able to structure their funds and financing arrangements in a multitude of different ways to suit their particular commercial and investment needs (and those of their investors).

Law stated - 10 January 2024

Financing considerations for fund formation
What financing considerations are particularly relevant during fund formation?

The exempted limited partnership agreement of an exempted limited partnerships (ELP) is essentially a contract between the general partner (GP) and the limited partners (LPs) that sets out the terms on which the partnership has been formed and will be operated, and the respective rights and obligations of the GP and LPs. As a result, the parties are generally free to agree the terms on which the ELP will operate. In a fund finance context, it is therefore important that the borrowing, guaranteeing and/or securing of the proposed facility is not restricted or prohibited by the exempted limited partnership agreement. It is particularly helpful if the exempted limited partnership agreement actively contemplates and permits the type of transaction in question. While not critical to include such provisions when forming the ELP, they should be incorporated (together with all other commercially agreed investment terms) into an amended and restated agreement prior to the admission of investors.

The above discussion regarding ELPs generally applies to other types of Cayman Islands entities where the constitutional documents (eg, in the case of a limited liability company, its limited liability company agreement, and, in the case of an exempted company, its memorandum and articles of association) also operate as a contract among investors, managers and/or the company, as applicable. However, certain statutory and common law rules do apply in some instances – for example, in the case of exempted companies, the company's memorandum and articles of association constitute a special kind of statutory contract among members and the company (comparable to English law).

Law stated - 10 January 2024

Use of proceeds
What are the proceeds of fund financings most typically used for? Has this evolved in recent years?

Historically subscription facilities were the most commonly used fund finance product. They allow the fund to use loan proceeds to bridge the timing gap between capital contributions from investors and the need to pay out cash to make investments or pay fund expenses. Subscription facilities also allow the consolidation of capital calls, thereby reducing administrative burden on the fund and investors.

Net asset value facilities, which seek to borrow against the underlying value of the fund’s investments, tend to be more varied in how loan proceeds are used. Historically, they might have been used to provide cash to the fund in order to make further investments, perhaps while awaiting the sale of existing investments, or to increase overall leverage. More recently, we are seeing their use as a means of making distributions to investors, or as an alternative to the secondaries market, thereby freeing up investor liquidity.

Law stated - 10 January 2024

TRANSACTION PARTIES

Credit support
Which entities within a fund group provide collateral and guarantee support for the different types of financings? Are there restrictions on which entities are permitted to provide such support for each type of financing?

This will vary from transaction to transaction, and will be determined by the commercial arrangements of the parties and the type of financing (eg, subscription or net asset value facility). Beyond its constitutional documents, as a matter of Cayman Islands law, there are no prohibitions on the provision of credit support by a Cayman Island entity. It is therefore important that due consideration is given to the terms of the entity's constitutional documents at the outset to ensure that the proposed financing will be permitted.

Law stated - 10 January 2024

Recourse
Are fund financings typically fully recourse to the obligors? Are there credit parties against whom recourse will ordinarily be expressly limited, whether for regulatory reasons or by virtue of customary practice?

Generally speaking, as a matter of Cayman Islands law, the commercial parties are free to agree the terms of recourse to Cayman Islands entities and there are no regulatory reasons or customary practice that serve to limit such recourse.

An exception to this is the statutory position that general partners are liable for the debts of an exempted limited partnership (ELP) should the assets of that ELP be insufficient to pay partnership liabilities on a winding up. This position, which arises under Cayman Islands statute, will be familiar to advisers in other jurisdictions where, similarly, general partners have general liability for the debts of the partnership (vs limited partners whose liability is limited).

Law stated - 10 January 2024

Liability
Where multiple fund entities are borrowers or guarantors, is joint and several liability typical, or is each entity liable only for its own obligations?

Generally speaking, as a matter of Cayman Islands law, the commercial parties are free to agree the terms of liability among the various obligors. We most frequently see joint and several liability among obligors under the main loan documents, which are usually not governed by Cayman Islands law, but this is not always the case. For example, in umbrella facilities, funds may be split into 'fund groups' and liability among funds within the same group will typically be joint and several, whereas this will not be the case as between the different fund groups. In each case, any joint and several liability for indebtedness will need to be anticipated by the underlying constitutional documents of the obligor.

Law stated - 10 January 2024

Lenders

What types of lenders typically provide fund finance products? Does this vary for different fund finance products? Are there any recent trends in the types of lenders entering or stepping back from the fund finance space?

Fund managers of Cayman Islands entities are typically based in the key onshore jurisdictions and will look to access capital in those jurisdictions. Therefore, trends in the lending market are not specific to Cayman Islands entities, and Cayman Islands entities are exposed to the full array of market trends. While the Cayman Islands does not drive these trends, the flexibility and modern statutory framework that underpins entities such as ELPs means that it remains at the heart of recent developments, particularly in the US and Asia.

While this is not unique to Cayman Islands entities, we – like other advisers in the market – are seeing a once fairly homogenous fund finance market, dominated by traditional banks, being replaced by an increasingly dynamic and multifarious market with a variety of bank and non-bank players. In our view, this represents a gradual evolution, due a combination of demand in the market for financing, the success of fund finance as a product, and macro-economics, and bodes well in terms of product diversity, market growth and overall access to capital.

Law stated - 10 January 2024

DUE DILIGENCE

Constituent documents

What are the typical fund constituent documents that require diligence? What are the most important issues to be considered in reviewing these?

Typically, the constitutional documents of the fund, the subscription agreements of investors and any side letters are reviewed to establish whether the appropriate borrowing, guaranteeing and/or securing powers (as applicable) exist without restricting the proposed transaction, and (in the case of side letters) whether there are any provisions that may necessitate exclusion of (or special treatment given to) the relevant investor when calculating the borrowing base.

In terms of restrictions, the most important issues to be considered are whether there are any limitations on indebtedness or credit support, including levels of indebtedness as a percentage of fund assets (whether capital commitments or investments) and any restrictions on cross-securing or cross-guaranteeing under the facility. Where a subscription facility is being put in place, a lender will also look to ensure appropriate capital call mechanics exist as well as remedies in a scenario where investors default on their capital contributions.

Law stated - 10 January 2024

Side letters

Are side letters between the fund parties and investors typical? What side letter provisions most commonly raise issues that may affect financings?

While there are no Cayman Islands law or regulatory considerations that typically present themselves in side letters relating to Cayman Islands entities, lenders should diligence any contractual arrangements between the fund and an investor prior to admitting that investor to the borrowing base. Those elements that are of particular importance in a fund financing are any restrictions imposed by the investor on levels of indebtedness of the fund, specific capital call requirements (eg, call notices in a particular form), immunity provisions, prescribed jurisdictions of enforcement and most favoured nation clauses.

Law stated - 10 January 2024

Investors

What is the typical scope of diligence performed on investors? Do investors commonly provide investor letters or other deliverables for the benefit of lenders? If so, in what context would this be expected?

Diligence on investors is generally driven by a lender's internal requirements. From a Cayman Islands perspective, it will be key to ensure that any investors falling into the borrowing base on a subscription line or hybrid facility are listed on the register of equity interests of the applicable Cayman Islands entity (eg, the register of limited partners or register of members). The fund should certify that such register is accurate and current, and the fund should undertake to provide the lender with any updates to investor details (eg, address, name or level of commitments to the fund).

Law stated - 10 January 2024

Other areas of due diligence

Are there other areas that merit due diligence considerations? What salient issues are relevant to each?

A fund that is formed as a Cayman Islands entity will, with certain limited exceptions, typically be a 'private fund' under the Private Funds Act (as revised) of the Cayman Islands (the PF Act). Private funds are required to register with the Cayman Islands Monetary Authority (CIMA) by submission of the requisite application form and offering memorandum (or summary of terms) within 21 days of a fund accepting capital commitments or, if earlier, prior to the fund receiving any capital contributions for the purpose of investments.

The detailed legislative requirements and process for registration are outside the scope of this response, but when lending to Cayman Islands funds, particularly in the context of subscription facilities, it is necessary to establish whether the fund is within the statutory scope and therefore required to register with CIMA, and whether it has so registered.

As well as establishing the status of the fund as a due diligence matter, it is now common practice for subscription facilities to include a standalone covenant with respect to registration and maintenance of such registration under the PF Act. The exact form of this covenant varies and is open to negotiation, but it is usual practice to require registration with CIMA prior to admission of the relevant fund or the inclusion of its investors in the borrowing base. Fund managers should have regard to this covenant as it could potentially have a timing impact (eg, at initial closing, where the original borrower needs to be registered as a condition precedent or on the joinder of a Cayman Islands entity).

Law stated - 10 January 2024

CREDIT SUPPORT – GUARANTEES, SECURITY AND COLLATERAL

Guarantors – subscription facilities
Which entities are typically obligors in the case of subscription facilities?

The borrower(s) and guarantor(s) will typically be the obligors under a subscription facility. Feeder funds may also provide security (in a cascading security structure or directly to the lender). Where any such party is an exempted limited partnership, typically its general partner will also be a security provider given that the right to call capital from investors is a contractual right of the general partner under the exempted limited partnership agreement.

Law stated - 10 January 2024

Guarantors – NAV facilities
Are pledged assets typically held at the fund level and pledged directly, or moved to a special purpose vehicle? Is there fund-level recourse in the case of NAV facilities?

Cayman Islands entities offer flexibility in this regard. While we commonly see assets held by intermediate or special purpose vehicles, this structuring is not driven by Cayman Islands law but usually a desire to isolate particular assets and/or incur borrowing or grant security lower down the fund structure. We note that there is an increasing trend, particularly in the US loan market, for the utilisation of bankruptcy-remote structures, and Cayman Islands law is well-suited to the implementation of such structures. These structures are, of course, only workable if assets are moved into the relevant entity (which will be made bankruptcy remote) prior to or at the time of the financing.

As to recourse, assuming the NAV facility is incurred downstream, we would not generally expect recourse to the fund level and the practical recourse of lenders will usually be limited to underlying investment assets of the fund against which the loan has been made. Such recourse is commonly indirect, through equity pledges of one or more intermediate entities that hold (directly or indirectly) the relevant investment assets. Moreover, it is likely the case that, at the time of incurring the NAV facility, investor commitments will be minimal or completely exhausted, meaning that there may be little or no benefit for lenders to having fund-level recourse.

Law stated - 10 January 2024

Collateral package – subscription facilities
What is the typical collateral package for subscription facilities?

Where a Cayman Islands entity is providing collateral in a subscription facility context, this will typically consist of a grant of security over (1) the rights under the constitutional or subscription documents to the capital commitments and capital contributions of each investor into the fund, including the right to call capital from investors and the right to enforce each investor's obligation to make capital commitments, and (2) the accounts into which capital contributions are made and held.

Law stated - 10 January 2024

Collateral package – NAV facilities
What underlying assets most commonly secure NAV facilities?

We see a variety of assets being provided as collateral for NAV facilities, but, generally speaking, the only Cayman Islands assets that are typically present in fund structures are the Cayman Islands entities themselves, such as an investment vehicle formed in the Cayman Islands. In this scenario, subject to the commercial terms of the security package, it is common to see security over the equity interests in these entities granted in favour of the applicable lender or collateral or security agent.

If the underlying investment is an equity interest in a Cayman Islands entity, such as a limited partnership interest in another fund formed and registered as an exempted limited partnership (ELP) in the Cayman Islands, then security can potentially be taken over this interest. It will, however, be important to review the exempted limited partnership agreement of the relevant entity to establish whether the taking of security is permissible, and whether any conditions (eg, consent of the general partner) apply. In our experience, it is generally the case that general partner consent is required (in relation to the grant of security over, or transfer on enforcement of, interests in third-party funds) and, in the unlikely scenario where the exempted limited partnership agreement is silent, the Exempted Limited Partnership Act (as revised) of the Cayman Islands imposes a requirement for general partner consent prior to or simultaneously with the grant of the relevant security interest.

Law stated - 10 January 2024

Pledge structure – subscription facilities
Which parties are typically required to pledge capital-call collateral and how are the pledges structured?

The overall approach to the security package, and in particular the entities that will provide capital-call collateral, follows the approach in other jurisdictions such as Delaware. As such, Delaware structures (or indeed structures with entities from other jurisdictions) can be supplemented with Cayman Islands entities with relative ease.

Law stated - 10 January 2024

Pledge structure – NAV facilities

If assets are held in a special purpose vehicle (SPV), are the assets pledged directly by the SPV, or is the pledge achieved indirectly through a pledge of equity interests in the SPV? Are any other pledge structures commonly seen?

We see both approaches taken, and what is appropriate will vary from transaction to transaction and will depend on a number of factors, including the nature of underlying investments, the contractual arrangements governing those investments, the ease with which security could be taken at different levels, and so on. However, security over an SPV is a common approach and certainly one that we regularly see in the Cayman Islands to ensure control of the relevant SPV through the life of a transaction. While fund entities are generally formed as ELPs in the Cayman Islands, we see the use of different Cayman Islands entities as SPVs, including exempted companies and limited liability companies (the former will be familiar to English legal practitioners, and the latter to US practitioners given its similarities to the Delaware equivalent).

Other pledge structures might include the pledge of bank accounts into which proceeds from underlying investments are paid (sometimes in addition to, or in lieu of, other collateral). While in our experience it is not often the case that such accounts are located in the Cayman Islands, in the event that they are then the taking of such security is relatively straightforward and will be familiar to English legal practitioners.

Law stated - 10 January 2024

Perfection and priority – subscription facilities

How are security interests in rights to uncalled capital and bank accounts perfected and how is priority established? Is any notice to investors necessary for perfection or priority and, if so, what are the requirements for such notices? In the case of bank accounts, is a tripartite account control agreement with the account bank, or other notice to or acknowledgement by the account bank, required?

The method for perfection or establishment of priority will depend on the document (and, in particular, the governing law of that document) under which those rights arise. In an ELP context, we expect such rights to arise under the exempted limited partnership agreement of the ELP, and as such they will be a chose in action governed by Cayman Islands law. Drawing on English case law in this field, in order to establish the priority of such security vis-à-vis third parties, it is necessary for notice of the security interest to be delivered to investors. There is no prescribed form for this notice, but it should be sufficiently clear so as to give investors notice of the security interest that has been granted, the grantor (which will be the GP and the ELP) and grantee. There is no requirement for investors to acknowledge the notice, or to take any action in relation to the notice, but it is now commonplace for lenders to require evidence of delivery (which is commonly via investor portal or email to investors) to be provided to the agent.

While it is relatively unusual for bank accounts to be located in the Cayman Islands in a fund finance context, the legal position for perfection and establishment of priority is essentially equivalent to that described above and, where there are Cayman Islands bank accounts, notice will generally be delivered to the account bank in order to establish priority as outlined above. There is typically no tripartite account control agreement entered into in a fund finance context, but the account bank is commonly requested to return a form of acknowledgment (attached to the notice) under which it will (among other things) (1) formally acknowledge the security interest and (2) agree, in an enforcement scenario, to act on the instructions of the lender or collateral or security agent, as applicable, to the exclusion of the grantor.

There is no central registration regime for security interests in the Cayman Islands for the above type of security interests and, as such, there is no requirement to make any filing comparable to a UCC-1 or similar.

Cayman Islands companies, including limited liability companies, are required to maintain a statutory register of mortgages and charges that must contain details of all security interests granted by the relevant company. Entry in this register is not required to perfect or establish the priority of the security interest in question – and failure to register does not in any way invalidate the security. Such register is not a public register but is open to inspection by any creditor or member of the company.

Law stated - 10 January 2024

Perfection and priority – NAV facilities

How is a security interest in each type of commonly pledged asset perfected, and how is its priority established?

The most common type of Cayman Islands asset to be pledged in a NAV facility context is the equity interest in a Cayman Islands entity, such as an ELP (eg, where the asset to be secured is the LP interest in the ELP).

The exempted limited partnership agreement of the ELP in question should be reviewed to establish whether the proposed grant of security is permitted, what conditions (eg, consent of the general partner) must be satisfied, and/or whether there are other procedural steps that must be fulfilled. In the event that the exempted limited partnership agreement is silent as to whether consent of the general partner is required, the Exempted Limited Partnership Act (as revised) of the Cayman Islands requires consent of the general partner prior to, or simultaneously with, the grant of the relevant security interest. Assuming compliance with the foregoing, notice of the security interest must be given to the ELP at its registered office in the Cayman Islands, and such notice must contain certain prescribed details (it must specify the agreement pursuant to which the security interest has been granted, the date thereof, the parties thereto, the identity of the grantor and grantee, and the partnership interest or part thereof that is subject to the security interest).

Security interests over the same limited partnership interest (or part thereof) will rank in priority by reference to the time such notice was validly served at the registered office of the ELP in question. The general partner is required by statute to maintain a register of security interests detailing any security granted over limited partnership interests in which all such notices must be recorded. This register must be available for inspection by any person during usual business hours.

Law stated - 10 January 2024

Lien searches and filing system
How can a lender assure itself as to the absence of liens, with or without priority to its lien, with respect to each type of collateral? Is a public filing or recordation system available in your jurisdiction to notify third parties of security interests?

There is no central registration regime for security interests in the Cayman Islands that has general application. Cayman Islands companies are required to maintain a statutory register of mortgages and charges, and the general partner of an ELP (or the limited liability company) must maintain a statutory register of security interests detailing any security granted over limited partnership (or member) interests, but failure to enter security into either register does not affect the priority or invalidate the security interest in question.

The register of mortgages and charges must be open to inspection by any creditor or member of the company in question at all reasonable times; the register of security interests over limited partnership or LLC interests must be available for inspection by any person during usual business hours.

Law stated - 10 January 2024

BORROWING BASE

Capital-call collateral value
How is the typical investor base determined in the case of subscription facilities? What are the typical events during the life of a credit facility that would exclude investors from the borrowing base? What are the common underwriting issues for lenders with respect to investor creditworthiness?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

Asset concentration limits
For NAV facilities, are there typically limits on exposure to various types of assets within the collateral pool? How are these limits determined?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

Asset valuation
For NAV facilities, what is the typical process for collateral valuation? What dispute mechanics are available?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

FINANCING DOCUMENTATION TERMS

Financial covenants

What are the principal types of financial covenants in the case of NAV facilities? Are any financial covenants typically included in subscription facilities?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

Other covenants

What other covenants restricting the operation of a fund are commonly included in financing documentation?

We see a broad array of restrictive covenants but these are invariably contained in the main loan documents, which we would not expect to be governed by Cayman Islands law.

Law stated - 10 January 2024

Repayment – subscription facilities

What is the typical maturity of a subscription facility? How long can individual loans remain outstanding?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

Repayment – NAV facilities

What is the typical maturity of a NAV facility, and what are the typical mandatory prepayment triggers? Are there customary exceptions? Are penalties for voluntary prepayment typical?

These are commercial matters to be agreed by the parties in the main loan documents, which we would not expect to be Cayman Islands law-governed.

Law stated - 10 January 2024

REMEDIES AND ENFORCEMENT

Defaults
What are the commonly included events of default specific to fund financings?

Events of default (EoDs) applicable to Cayman Islands entities generally follow those applicable to entities in other jurisdictions. The nature and terms of such EoDs are a commercial matter for the parties to agree, and are typically set out in the main loan documents, which we would not expect to be governed by Cayman Islands law.

That said, it is common in subscription facilities for lenders' counsel to seek the inclusion of a specific event of default for breach of the PF Act covenant. This is a covenant generally included in subscription facilities that, among other things, requires borrowers or other credit support providers that are within the scope of the PF Act to register with the Cayman Islands Monetary Authority (CIMA) prior to their admission to the credit agreement, and, thereafter, to maintain their registration with CIMA. The precise terms of the covenant and the associated EoD vary and are open to negotiation by the parties.

Law stated - 10 January 2024

Standstill
What types of standstill provisions are typically available in the case of subscription facilities?

Standstill provisions applicable to Cayman Islands entities typically follow those applicable to entities in other jurisdictions.

Law stated - 10 January 2024

Enforcement – capital calls
How does a lender enforce its right to call capital from investors in the case of a defaulted subscription facility?

In the US market, it is standard practice for security documentation (including security over capital call rights) to be governed by the relevant US jurisdiction. In this scenario, the precise enforcement rights are a matter of the relevant governing law, but invariably these include the ability of the collateral or security agent to call capital to repay the secured obligations. This would, under the terms of the constitutional documents of the relevant Cayman Islands entity, comprise the issuance of a capital call notice to investors (eg, limited partners in the exempted limited partnership). The circumstances in which a capital call notice can be delivered, and the terms governing the payment of capital contributions, will be governed by the constitutional documents of the relevant fund (which, generally speaking, operate as a contract between the fund and/or its general partner and investors). These cannot be varied by the terms of the loan documents.

In the European market, it is common practice for capital call security to be governed by a standalone Cayman Islands law-governed security deed. That said, at a high level, the enforcement mechanics will be largely comparable to those in US documentation, and the most immediate remedy is the calling of capital commitments as described above. Cayman Islands security (like their US equivalents) will also include a power of sale, enabling the sale of the rights to call capital and to capital commitments to a third party.

Law stated - 10 January 2024

Enforcement – NAV facility collateral

What steps must a lender take to foreclose on pledged underlying assets, including in cases where assets are pledged indirectly through a pledge of equity interests in a holding company?

Typically, the Cayman Islands assets that are secured in the context of NAV facilities comprise equity interests in the relevant Cayman Islands entity. The exact process for enforcement will be fact dependent and will depend on the type of Cayman Islands entity in question, but generally speaking the remedy will be to sell or otherwise transfer the equity interests in the relevant entity, with the proceeds of such sale then applied towards discharge of the secured obligations.

Law stated - 10 January 2024

Enforcement – bank accounts

What steps are needed for a lender to take control over funds or securities held in pledged accounts?

In circumstances where funds or securities are held in an account in the Cayman Islands, and the account bank has returned a signed acknowledgment agreeing to act (to the exclusion of the grantor) on the instructions of the collateral or security agent, enforcement will usually entail delivery to the account bank of (1) a notice notifying the account bank that an event of default has occurred and, as a result, they are to act only on the instructions of the collateral or security agent only, and (2) instructions to the account bank to pay or transfer to an account of the collateral or security agent the proceeds or securities standing to such account.

Law stated - 10 January 2024

Bankruptcy and insolvency

How do bankruptcy and insolvency proceedings in respect of a fund affect the ability of a lender to enforce its rights as a secured party over the collateral? Are processes other than court proceedings available to seize pledged assets in enforcement?

There is no stay or moratorium under any Cayman Islands insolvency or restructuring proceedings on the enforcement by secured creditors of their security interests. As such, secured creditors will remain able to enforce their security in accordance with its terms, notwithstanding any insolvency or restructuring proceedings in the Cayman Islands.

Under Cayman Islands law-governed security, the secured creditor will typically have the right to appoint a receiver, which is essentially a self-help remedy pursuant to which the secured creditor will be able exercise its rights under the relevant security agreement (eg, the power of sale) without leave of the Cayman Islands courts (ie, it is an out-of-court process).

Law stated - 10 January 2024

LEGAL AND REGULATORY ISSUES

Relevant regulatory and statutory regimes

Are there any regulatory or statutory regimes that raise particular issues for lenders or fund sponsors in fund financings? How are these issues normally addressed?

A fund that is formed as a Cayman Islands entity will, with certain limited exceptions, typically be a 'private fund' under the Private Funds Act (as revised) of the Cayman Islands (the PF Act). Private funds are required to register with the Cayman Islands Monetary Authority (CIMA) by submission of the requisite application form and offering memorandum (or summary of terms) within 21 days of a fund accepting capital commitments or, if earlier, prior to the fund receiving any capital contributions for the purpose of investments.

When lending to Cayman Islands funds, particularly in the context of subscription facilities, it is necessary to establish whether the fund is within the statutory scope and therefore required to register with CIMA, and whether it has so registered. Failure by a fund to register in a scenario where it should do so does not directly invalidate the contractual obligation of an investor to commit capital to the fund in accordance with the exempted limited partnership agreement. However, it may lead to penalties and enforcement action by CIMA, which may result in reluctance by an investor to contribute capital.

As well as establishing the status of the fund as a due diligence matter, it is now common practice for subscription facilities to include standalone covenants with respect to registration and maintenance of such registration under the PF Act. The exact form of this covenant varies and is open to negotiation, but it is now usual practice to require registration with CIMA prior to admission of the relevant fund or the inclusion of its investors in the borrowing base.

Law stated - 10 January 2024

Governing law

What is the typical choice of law and choice of jurisdiction in the finance documentation? What conflict-of-laws considerations are typically relevant to fund financings in your jurisdiction?

We would not usually expect the credit agreement and other main loan documents to be governed by Cayman Islands law.
In addition, from a Cayman Islands perspective, it is not necessary for a security agreement to be governed by Cayman Islands law where there are Cayman Islands situs assets. In the US subscription line market, it is standard for the governing law of the capital call

security agreement to follow the governing law of the main loan documents, with minimal changes. In subscription facilities governed by English law, we typically see standalone Cayman Islands law-governed security, but this is not a requirement of Cayman Islands law and is more a reflection of market practice. The same analysis can apply to NAV facilities, but it is more common (though not essential) for any security over Cayman situs underlying portfolio assets (whether Cayman Islands companies or exempted limited partnerships) to be governed by a Cayman Islands law security agreement.

Questions of conflicts of law are complex and fact specific. That said, Cayman Islands courts will generally uphold the choice of law provisions in security agreements, allowing parties to select the law applying to their contractual arrangement. However, regardless of the governing law of the security agreement, in the case of intangible movables such capital call rights or equity interests, the formalities for the establishment and perfection of such security will depend on the governing law of those rights or interests. For security over capital call rights governed by Cayman Islands law, the priority as between successive assignees or charges will be determined by the order in which notice is given to the investor (eg, the LP in the context of an exempted limited partnership (ELP).

The steps required to establish and perfect (and protect) security over equity interests in a Cayman Islands entity will depend on the type of entity in question and its constitutional documents, although additional considerations can arise where, for example, the equity interest in question relates to shares in a Cayman Islands company and its register of members is maintained in another jurisdiction.

Law stated - 10 January 2024

Document execution

What are the requirements and formalities for the execution of financing documentation? Are there any jurisdiction-specific issues that arise in the fund financing context?

It is generally unusual for the constitutional documents of a Cayman Islands entity to impose particular formalities on the execution of documents, and generally speaking (but subject to the below) a duly authorised person acting on behalf of a Cayman Islands entity may sign on behalf of that entity without observing any additional formalities (unless imposed by the governing law of the relevant document). In the context of ELPs, it should be noted that the partnership acts through its GP, so an authorised person acting on behalf of the GP (in turn, acting on behalf of the ELP) will generally execute the documents.

If there is a Cayman Islands law-governed security document, this will likely contain a power of attorney to be used by the collateral agent, security agent or lender in an enforcement scenario. Any Cayman Islands law-governed document containing a power of attorney must be executed by way of a deed to comply with Cayman Islands statutory requirements.

Any legal assignment must be in writing and signed by both parties (assignor and assignee). This is standard practice for security documentation containing an assignment of capital call rights.

Law stated - 10 January 2024

UPDATE AND TRENDS

Key trends and developments

What are the most noteworthy recent trends and developments in fund finance in your jurisdiction? What developments are expected in the coming year?

The Cayman Islands fund finance market has gone from strength to strength in recent years. Subscription facilities have become a staple for funds established in the Cayman Islands and we have seen a significant increase in the use of net asset value (NAV) facilities since 2020. Difficulties in valuations, macro-economic conditions and a choppy private equity market have encouraged fund managers and investors to look to, and become more comfortable with, NAV facilities, which we now see used for a variety of reasons and which are becoming a more established tool for leverage and liquidity.

From our viewpoint, the consolidation of certain lenders in the US market only briefly slowed lending activity and the second half of 2023 saw ever increasing numbers of fund finance facilities linked to Cayman Islands entities.

In the coming year, we anticipate a continued strong demand in the subscription facility market as well as a further uptick in the NAV space as funds continue to navigate the difficulties in valuation of underlying portfolio assets. We expect that extensions to existing facilities, albeit generally on lower borrowing levels and/or at higher margins, will continue to be a common feature. Based on current trends, we also expect the use of bankruptcy remote structures in the context of NAV facilities to also increase (given the benefits these provide and increased familiarity with these structures among market participants).

Law stated - 10 January 2024