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The Cayman Islands Private Funds Law: a practical guide for fund finance lenders

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On February 7 of this year, the Private Funds Law, 2020 (the **Law**), which mandates the registration and regulation of certain closed-ended funds (**Funds**), came into effect in the Cayman Islands. While the new regime enacts a variety of provisions of interest to the broader funds industry, this note focuses specifically on the core aspects that are of relevance to those lending to such Funds and the practical steps lenders should consider taking as a result.

Application of the Law

Types of funds caught

The Law applies to all "private funds"[1]. While, as a practical matter, this will likely encompass the vast majority of closed-ended fund structures that lenders encounter (including AIVs), the Law expressly excludes various "non-fund arrangements" from its ambit. The precise definition of each such arrangement remains to clarified by further regulation, but they include: securitisation special purpose vehicles, structured finance vehicles, individual investment management arrangements, debt issues and debt issuing vehicles, sovereign wealth funds, and single-family offices.

1 A private fund is defined as a company, unit trust or partnership whose principal business is the offering and issuing of its investment interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from such entity's acquisition, holding, management or disposal of investments, where (a) the holders of investment interests do not have day-to-day control over the acquisition, holding, management or disposal of the investments, and (b) the investments are managed as a whole by or on behalf of the operator of the private fund, directly or indirectly, for reward based on the assets, profits or gains of the company, unit trust or partnership.

Key contacts

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When a Fund must register

Subject to the transitional period detailed below, a Fund must register with the Cayman Islands Monetary Authority (**CIMA**) before receiving capital contributions from investors "for the purposes of investments" (**Contributions**). Prior to such point, it would thus appear that a Fund can, in theory, postpone registration without breaching the Law. Notably however, the Law further provides that a Fund that receives Contributions must have applied to register with CIMA within 21 days from the date on which it first accepted investor commitments. How the Law will apply to a Fund that has not received Contributions but that seeks to register with CIMA after such 21 day period has expired remains to be seen, but the prudent approach would appear to be to ensure registration before such date.

Transitional period

Funds may receive Contributions prior to August 7, 2020 (the **Deadline**) without being registered. From and following such date, a Fund will need to be registered with CIMA if it has previously received Contributions or in order to receive Contributions going forward.

Impact of non-compliance

The receipt of Contributions may be prohibited

The fact that a Fund is prohibited from receiving Contributions until it is registered with CIMA may mean that its failure to comply with such requirement could endanger the ability of a lender to rely on the commitments of the Fund's investors for repayment; a possibility of acute relevance in the context of a standard subscription line facility. While there are potential arguments in favour of the view that the Law would not prohibit contributions made to repay a lender notwithstanding such non-compliance (for example, the reference to "*in respect of investments*" might arguably be read as excluding contributions received solely for the purpose of repaying liabilities), lenders will of course prefer to avoid being a test case on the point.

Other ramifications

Non-compliance with the Law may also result in certain other steps being taken with respect to the Fund, including: (i) fines being imposed on the Fund and/or its operator, (ii) CIMA appointing one or more persons to assume control of the Fund, and (iii) CIMA applying to the Grand Court for an order to take such other action as it considers necessary to protect the interests of investors in, and creditors of, the Fund. While these may of course impact a lender's position in certain circumstances, well drafted step-in rights and a sufficiently robust security package should ultimately protect a lender from being materially disadvantaged by such steps occurring.

Practical steps

In light of the foregoing and the broader provisions of the Law, we would generally recommend that lenders consider taking the following steps.

New funds

Lenders and their onshore counsel will likely wish to include various new provisions in their future deal documentation to address the specifics of the Law. For example, we would generally recommend ensuring that the receipt of reasonable documentary comfort regarding the registration of the relevant Funds be made a condition precedent to utilisation (whether in the form of a certificate of registration from CIMA, searches of the CIMA database, and/or opinions on the point from the Funds' local counsel).

Identifying exposure to existing Cayman Islands entities

Lenders should consider examining their existing portfolio to identify the extent to which they plan to lend, have lent, or are committed to lend to Cayman Islands entities to determine to which transactions the Law may be relevant.

Discussion with relevant counterparties

Lenders should further consider making contact with clients that they have identified as potentially within the scope of the Law to determine (i) if such client has concluded whether or not the Law will apply, and (ii) if applicable, when they plan to complete the registration process, and how they intend to ensure ongoing compliance.

Where a Fund has determined that registration is not required

Lenders should carefully consider the accuracy of any conclusion by a Fund that it falls outside the scope of the Law, and may wish to receive confirmatory analysis from their own Cayman Islands counsel and/or a formal opinion on the point.

Where an existing Fund is within the scope of the Law and has already received Contributions

A standard covenant and representation package should mandate compliance with applicable law and thus with the registration requirement prior to the Deadline. Practically however, given the potential impact of such a failure on the right to receive Contributions, it may be small comfort to a lender that a breach of the same will likely result in an event of default. As such, in addition to the client discussions suggested above, it may worth determining whether the transaction documents in each case require a Fund to register in advance of the Deadline.

Continued

Where an existing Fund is within the scope of the Law and has not yet received Contributions

As detailed above, given registration is not required until Contributions are received, a Fund that has not done so may be entitled to operate following the Deadline without registering, notwithstanding that it would amount to a breach of the Law to receive Contributions after such date. To the extent that a lender has advanced or may otherwise be obliged to advance sums to such a Fund, it should consider whether the terms of the transaction documents permit the Fund to draw down on the facility notwithstanding the absence of registration, or whether (for example, in order to ensure the enforceability of the commitments) they mandate registration prior to the point at which it would technically be necessary under the Law.

Where a Fund that is registered as required ceases to maintain such registration

As above, the Law states that Contributions may not be accepted by a Fund “until it is registered”. While it is not clear what impact a lapsed registration would have on the ability to receive Contributions that were previously available, it would be prudent in our view to assume this may prevent future drawdowns. As such, lenders may wish to ensure that, (i) to the extent it would not already, such a failure to maintain the registration would constitute an event of default; and (ii) the power of attorney afforded to the lender includes explicit language to allow it to remedy any failures by a Fund to maintain its registration.

The foregoing is intended as a general summary of the more common considerations and steps that may be applicable following the enactment of the Law. Additional considerations and steps may of course be worthwhile depending on the circumstances. Please reach out to one of our contacts if you would like to discuss further.

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