

Private equity funds in the Cayman Islands

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Introduction

The Cayman Islands is the largest domicile for private equity funds outside of the US. The success of the jurisdiction has, to a large extent, been based on the sophistication of its legal regime which has constantly evolved to keep pace with the global regulatory environment and the demands of its key stakeholders. To this end, the Cayman Islands has recently introduced a regulatory regime for 'closed-ended' private funds which seeks to further strengthen investor confidence and to ensure it remains the preeminent jurisdiction for fund formation.

The term 'private equity fund' commonly denotes a non-retail fund investing in illiquid assets and, whilst used most frequently in the context of a typical buyout fund, covers a range of funds including real estate funds, venture capital funds, infrastructure funds, credit opportunity and other debt funds, secondary funds and funds of funds.

Private equity/closed-ended funds established in the Cayman Islands normally take the form of exempted limited partnerships (which will be the focus of this guide), although may be formed as companies.

Regulatory overview

The Private Funds Act, 2020 (the **PF Act**) came into force on 7 February 2020 and was further amended on 7 July 2020 by the Private Funds (Amendment) Act, 2020. The PF Act requires private fund vehicles to register with the Cayman Islands Monetary Authority (**CIMA**) within 21 days of accepting capital commitments from investors but, in any event, prior to the fund accepting capital contributions from investors for the purposes of investments.

Key definitions

The PF Act applies to 'private funds'. A **private fund** is a vehicle that offers or issues or has issued investment interests, the purpose or effect of which is the pooling of investor funds with the aim of enabling investors to receive profits or gains from the vehicle's investments, where: (a) the investors do not have day-to-day control over those investments; and (b) the investments are managed by or on behalf of the fund's operator.

The definition of 'private fund' excludes certain 'non-fund arrangements'. Those non-fund arrangements include pension funds, securitisation SPVs, joint ventures, proprietary vehicles, holding vehicles, individual investment management arrangements, debt issues and debt issuing vehicles, structured finance vehicles, sovereign wealth funds and single family offices.

Registration requirements

An application for registration is made via CIMA's online filing portal. The application will need to include:

1. application form;
2. application fee – US\$366;
3. Certificate of Incorporation/Registration (as applicable);

4. constitutive documents (Memorandum & Articles of Association/Trust Deed/Declaration of Partnership, as applicable);
5. Offering Memorandum/Summary of Terms/Marketing Material (as applicable);
6. administrator's letter of consent (optional);
7. auditor's letter of consent (if available); and
8. structure chart.

All private funds are required to pay an annual registration fee of US\$4,270 at the time of registration.

The registration date on the private fund's registration certificate will be the date that a complete application has been received by CIMA (ie the submission date when the private fund has submitted all documents, fees and information).

Ongoing obligations for private funds

The PF Act includes the following ongoing obligations to:

- inform CIMA of any material changes to the information submitted in the registration application or the fund's offering document or prescribed details filed with CIMA (as applicable) or of a change in the fund's registered or principal office, within 21 days of making the change;
- pay an annual fee to CIMA by 15 January each year;
- file an annual return with CIMA;
- have the fund's accounts audited annually by a Cayman Islands approved auditor, together with an obligation to file audited accounts with CIMA within 6 months of the fund's financial year end; and
- retain records in accordance with CIMA's published rules, guidance and policies.

A minimum of two natural persons are required as directors for companies (or to be named in respect of a general partner or corporate director). There is no requirement for directors to be registered or licensed under the Directors Registration and Licensing Act, as is the case for directors of open-ended funds.

The PF Act also imposes requirements regarding asset valuations, safekeeping of assets and title verification, cash monitoring and (where applicable) identification of securities. Asset valuations, safekeeping and cash monitoring are required to be conducted by an independent third party but may also be conducted by the fund's manager or operator, provided that the relevant function is independent from the portfolio management function or the potential conflicts of interest are identified, managed, monitored and disclosed to investors.

Private funds are also required to comply with Cayman Islands anti-money laundering legislation.

Exempted limited partnerships

An exempted limited partnership (ELP), the typical vehicle of choice for a private equity fund domiciled in the Cayman Islands, is formed under, and subject to, the Exempted Limited Partnership Act (the **ELP Act**). The ELP Act adopts principles similar to those enshrined in the Delaware Revised Uniform Limited Partnership Act, and this similarity with the Delaware model makes the ELP particularly attractive to managers and investors in the US. The key provisions of the ELP Act are summarised below.

There are no capital gains, income, withholding, estate or inheritance taxes in the Cayman Islands. The ELP will apply for (and can expect to obtain) an undertaking from the Cayman Islands government that no form of taxation that may be introduced in the Cayman Islands will apply to the ELP for a period of 50 years from the undertaking being given (hence the ELP's 'exempted' status).

Key features

Notwithstanding its registration in the Cayman Islands, an ELP does not have a legal personality of its own. It is, to this extent, a combination of contractual rights and equitable interests in the assets of the ELP, which are held on trust for the partnership by the general partner (and, if there is more than one, by the general partners jointly) in accordance with the terms of the limited partnership agreement (the **LPA**).

The general partner (the **GP**) is the operative legal entity responsible for managing the business of the ELP and is ultimately liable for all debts and obligations of the ELP to the extent that the ELP has insufficient assets. The GP will sign all contracts on behalf of and in the name of the ELP. The GP may be a Cayman resident individual, a Cayman registered company, a foreign company or foreign partnership registered in

Cayman or another ELP. No additional licences or approvals will be required for the GP, and the GP may have any number of directors who will not be required to be resident in Cayman or to meet in Cayman.

Not having its own legal personality, the ELP is generally regarded from an onshore tax perspective as being tax transparent (or as having 'look-through' or 'flow-through' status) with the effect that the ELP itself will not be liable to any onshore taxes, and value distributed by it will 'flow-through' to the investors (and may be subject to local taxes in their hands).

There are no restrictions on the number of investors that may be admitted to an ELP.

Registration of an ELP and GP can take place on a same-day basis, with the certificates of registration following within three to five working days (a fast track process delivering the certificate in around 48 hours is also available).

The ELP Act

The ELP is essentially a creature of contract, and is formed by the signing of an LPA by the GP and by at least one limited partner. At this point, the LPA will often be a short-form document and will be accompanied by a 'Section 9 Statement' made by the GP confirming certain basic details about the ELP and lodged with the Registrar of Exempted Limited Partnerships in the Cayman Islands. A short-form LPA is typically amended and restated to set out the detailed commercial terms of the fund and will form the basis upon which investors will be admitted into the partnership.

The GP and the limited partners may agree between themselves the terms governing the partnership, subject to a relatively light overlay of statutory provisions contained in the ELP Act. Some of the provisions of the ELP Act are mandatory, and some can be varied or waived in the LPA.

The following provisions of the ELP Act are mandatory:

- The ELP's name must include the letters 'LP', 'L.P.' or the words 'Limited Partnership'.
- The ELP must have a registered office in the Cayman Islands, for service of process and forwarding of notices and communications.
- The ELP cannot undertake business with the public in the Cayman Islands (other than as may be necessary for the carrying on of its business outside the Cayman Islands); this is the basis on which the ELP obtains its 'exempted' status.
- The GP must act at all times in good faith and, subject to any express provisions of the LPA to the contrary, in the interests of the ELP.
- The GP is liable for any debts and obligations of the ELP if the ELP's assets are insufficient to discharge them. Any debt or obligation incurred by the GP in the conduct of the ELP's business shall be treated as a debt or obligation of the ELP. Any property of the ELP conveyed to the ELP or to its GP will be deemed to be held by the GP on trust for the ELP as an asset of the ELP.
- A limited partner may not participate in the conduct of the ELP's business, and all contractual documents and papers must be executed by the GP as the contracting party acting on behalf of the ELP. Any limited partner participating in this way, as though it were a general partner, will be liable for the debts and obligations of the ELP, if it becomes insolvent, to any person transacting business with the ELP through the limited partner and who had actual knowledge of such limited partner's participation and who reasonably believed that limited partner to be a general partner.
- The ELP Act set outs certain non-exhaustive 'safe harbour' activities in which a limited partner may engage without risk of losing its limited liability status; a limited partner's participation on an advisory board or investment committee will typically be within the safe harbours.
- If a limited partner receives a return of any part of his contribution or is released from any outstanding obligation in respect of his commitment to the partnership at a time when the ELP is insolvent (including where the payment or release causes the insolvency) and the limited partner has actual knowledge of the insolvency of the ELP, that limited partner shall be liable to the ELP for six months from the date of payment or release for the amount of the payment or the due performance of the released obligation.
- A limited partner may transfer all or any part of its partnership interest in the manner provided by the LPA, but such transfer shall not absolve the transferor of any liability previously incurred in respect of:

(a) its taking part in the conduct of the ELP's business; or (b) amounts of capital received and required to be returned (both as described above).

- An ELP shall continue until wound up and dissolved by resolution of the general partners and a two thirds majority of limited partners, unless the LPA provides otherwise; and the provisions of the Companies Act and the Companies Winding Up Rules shall apply to govern the winding up and dissolution of an ELP (except to the extent that such provisions are inconsistent with the ELP Act).
- If, following the ELP's registration, any change is made to its name, the general nature of its business, its registered office address, its duration or the name and address of its GP (or one of them), the GP must file with the Registrar of Exempted Limited Partnerships a statement of the change within 60 days of its occurrence. Any removal, replacement or admittance of a GP must be notified to the Registrar within 15 days and the relevant change is not effective until that notice has been filed.
- The GP must maintain or cause to be maintained: (a) a register of limited partners; (b) a record of the amount and date of the contribution or contributions of each limited partner and the amount and date of any payment representing a return of the whole or any part of the contribution of any limited partner (both of which must be updated within 21 days of any change); and (c) a register of security interests in respect of partnership interests in the ELP. The register of limited partners is open to inspection by any partner subject as may be provided in the LPA and by non-partners with the consent of the GP. The record of contributions is open to inspection by any person, with the consent of the GP and the register of security interests is open to inspection by any person.

Certain other key provisions of the ELP Act are non-mandatory or non-prescriptive in effect, and may be adopted or varied in the LPA as may be agreed between the partners, for example:

- The limited partners will not be liable for any debts and obligations of the ELP if the ELP's assets are insufficient to discharge them.
- The ELP Act provides that a limited partner may demand and receive from the GP information about the ELP's business and financial condition, but the LPA may waive or vary this provision (subject to the obligation of an open-ended partnership registered with CIMA to prepare accounts and have them audited).
- A GP or limited partner may contract with, or lend money to, the ELP *qua* partner or otherwise, subject to the inviolable duty of the GP to act in good faith in the interests of the ELP and to any debt owed by the ELP to a GP transacting in such manner ranking behind the ELP's other creditors (secured or unsecured).
- No capital commitment is required of the GP or of a limited partner (although the LPA will typically provide for such). Contributions may be made in cash, property or other assets (but not by way of loan by a partner to the ELP).
- The GP may take an interest in the ELP as a limited partner in addition to its interest as GP.
- The ELP Act provides, subject to any provision of the LPA to the contrary, that the ELP shall be automatically dissolved on the expiration of 90 days following the service, by or on behalf of, the sole or last remaining GP, of notice of the GP's death, bankruptcy, dissolution, winding up, withdrawal or removal, unless a majority of partners (or other majority specified in the LPA) elects within that 90 day period to appoint one or more new general partners.

Save as mentioned above, the LPA may contain such terms as may be agreed between the general partner and the limited partners.

Side letters

The GP of an ELP may enter into side letters with individual investors to provide for contractual arrangements additional to those contained in the LPA. It is common for investors entering into side letters to demand most favoured nation (**MFN**) clauses guaranteeing them the same rights extended to other recipients of side letters. These arrangements are unobjectionable under Cayman Islands law, but the normal steps must be taken to ensure that the terms of a side letter (and any MFN arrangements) are not in contravention of, or inconsistent with, the terms of the LPA. Nothing in the side arrangements can be allowed to prevent the GP from discharging its obligation under Cayman Islands law to act at all times in the good faith and (subject to any express provisions of the LPA to the contrary) in the interests of the ELP.

Consideration should be given to making specific provision in the LPA for the GP to enter into side arrangements with individual investors within specified parameters. In all cases, Cayman Islands legal advice should be sought.

Legal opinions

A legal opinion will typically be required from the fund's onshore and offshore legal advisors. The offshore opinion will be addressed to the investors and will cover:

- the valid formation and good standing in the Cayman Islands of the ELP and its GP;
- the ability of the ELP (acting by the GP) to enter into the LPA and other documentation;
- the limited liability status of the limited partners;
- the enforceability of the LPA and other documentation; and
- the enforceability of the obligations thereunder of the GP.

Conclusion

The tax exempt, tax transparent and highly flexible nature of the ELP make the Cayman Islands the preeminent jurisdiction for offshore private equity funds. Mourant's Cayman funds advisory team is well placed to assist managers, sponsors and investors with all aspects of Cayman law and regulation pertaining to investment funds.

Contacts

A full list of contacts specialising in private equity can be found [here](#).

This guide is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this guide, please get in touch with one of your usual contacts. © 2018 MOURANT OZANNES ALL RIGHTS RESERVED