

Taking security over limited partnership interests in a Cayman exempted limited partnership

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Introduction

One of the major advantages of the Cayman Islands as an international financial centre is that it provides a simple, flexible and robust regime for secured financing transactions that is attractive to lenders.

Cayman Islands exempted limited partnership

A Cayman Islands exempted limited partnership (**ELP**) is the typical vehicle of choice for private equity fund structures and will be formed under, and subject to, the Exempted Limited Partnership Act (as amended) of the Cayman Islands (the **ELP Act**). An ELP does not have separate legal personality. Its business is conducted by the general partner and all contracts are entered into by the general partner on behalf of the ELP. For further details on ELPs, please see our guide on [Cayman Islands exempted limited partnerships](#).

In a typical private equity fund structure utilising an ELP, investors (who are usually institutional investors including pension funds, endowments, as well as high-net-worth (**HNW**) individuals) will invest in the fund as a limited partner. A limited partner is a passive investor who does not have any right to participate in the management of the ELP and would agree to make capital contributions to the ELP in return for limited partnership interests (**LP interests**) pursuant to a limited partnership agreement (**LP Agreement**). LP interests are recorded in a register of limited partners (the **Register of LP**) which is maintained by the general partner of the ELP. The Register of LP is open for inspection by any person with the consent of the general partner during usual business hours.

LP interests as collateral

It is increasingly common to see LP interests being used as collateral for a variety of financing purposes, including the following:

- financing an investor's capital contributions under an LP Agreement;
- where private banks provide financing to HNW and ultra-high-net-worth (**UHNW**) individuals to fund their acquisition of private equity fund interests or investment in other financial products; and
- net asset value (NAV) financing in respect of a fund which holds investments through an ELP as a holding vehicle.

This guide examines the mechanism and key considerations when taking security over LP interests.

Security basics

A limited partner of an ELP may grant security over the whole or any part of its LP interests (the **Secured LP Interest**) with the written consent of the general partner under the ELP Act, unless the LP Agreement expressly provides otherwise (which may dispense with or modify the requirement for such consent).

Security document

The ELP Act is silent on the requirements for the creation of security over the Secured LP Interest. Nevertheless, the basic requirements are that the security document must:

- be created in writing;
- be signed by the chargor (being the security provider, the **chargor**); and
- clearly indicate the:
 - intention to create security over the Secured LP Interest; and
 - amount secured or how that amount is to be calculated.

In practice, the security will typically be created under the terms of a security document in the form of a charge and security assignment (which includes the title, rights and interests to which the chargor is entitled pursuant to the LP Agreement and the ELP Act, including rights to distributions and return of capital). This means the chargor remains on the Register of LP and continues to be liable to perform its obligations under the LP Agreement (including complying with any call for capital contribution by the general partner).

In addition, the security document should also:

- specify (either directly or by reference to another document) the defaults that entitle the chargee (being the recipient of the security, the **chargee**) to enforce the security;
- specify the chargee's enforcement powers and remedies; and

- include a power of attorney.

Stamp duty

No stamp duty is payable on the creation of security over the Secured LP Interest or any transfer of the Secured LP interest on the enforcement of the security unless the security document or any ancillary documents are executed in, or brought into, the Cayman Islands.

Formalities

The security document does not need to be notarised or apostilled.

First steps

Due diligence

Before taking security over the Secured LP Interest, the chargee should (among other things):

- review the LP Agreement to confirm:
 - that the chargor can grant security over the Secured LP Interest;
 - whether the general partner's written consent is required (or whether the LP Agreement provides otherwise) for:
 - the creation of security over the Secured LP Interest; and
 - the transfer of the Secured LP Interest upon enforcement of the security; and
 - whether there are other conditions, restrictions or fetters on the creation or enforcement of security over the Secured LP Interest;
- review the subscription agreement entered into by the chargor and the terms upon which it has agreed to subscribe for LP interests in the ELP;
- review any side letters which may have been entered into by the chargor with the ELP to confirm if there are any other restrictions or fetters on the creation or enforcement of security over the Secured LP Interest; and
- inspect the statutory registers (or an extract thereof) of the ELP, including:
 - the Register of LP to ensure that the chargor is the registered holder of the Secured LP Interest;
 - the record of contributions to check the capital commitments and capital contributions made by the chargor in respect of the Secured LP Interest; and
 - the register of security interests (the **Register of Security Interests**) maintained by the general partner (see 'Registrations and filings – Perfection requirements – Register of Security Interests' below for more information about the Register of Security Interests) to ensure that there is no evidence of any existing security over the Secured LP Interest.

Regulatory approvals

No regulatory approvals are required to create or enforce security over the Secured LP Interest unless the ELP is a regulated entity in the Cayman Islands.

Security deliverables

The chargor will typically be required by the security document or (where relevant) the loan agreement to deliver the following documents to the chargee:

- a written consent from the general partner (as required under the ELP Act) on:
 - the grant of security over the Secured LP Interest; and
 - the transfer of the Secured LP Interest upon the enforcement of the security,
 or, where such requirement is expressly dispensed with or modified under the LP Agreement, such other requirements under the LP Agreement;
- an undated instrument of transfer (or a transfer agreement in the ELP's prescribed form) in respect of the Secured LP Interest signed in blank; and
- any other requirements as may be set out in the LP Agreement (and/or any side letters) for:
 - the chargor to grant security over the Secured LP Interest; and

- the transfer of the Secured LP Interest upon enforcement of the security.

Registrations and filings

Perfection requirements

Notice and acknowledgment of security

Under the ELP Act, written notice of the creation of security over the Secured LP Interest (**Notice of Security**) must be given by the chargor or chargee to the ELP at its registered office. A Notice of Security is not validly given to the ELP unless it sets out the following information:

- details of the agreement creating the security interest (including the date of the agreement and parties to it);
- details of the chargor and chargee; and
- details of the Secured LP Interest.

In practice, if the Notice of Security is given to the ELP by the chargor (which is often the case), the chargee would typically require a copy of the Notice of Security provided by the chargor and an acknowledgement from the general partner.

Register of Security Interests

The general partner of an ELP must maintain, or cause to be maintained, at the registered office of the ELP a Register of Security Interests. The Register of Security Interests must register each security interest in relation to which a valid Notice of Security has been served on the ELP and contain the following particulars in respect of each Secured LP Interest:

- identity of the chargor and chargee;
- details of the Secured LP Interest; and
- date on which the Notice of Security was validly served on the ELP.

The Register of Security Interests may be inspected by any person during usual business hours.

Priority

Any security interest over LP interest shall have priority according to the time that the Notice of Security is validly served at the registered office of the ELP.

The chargee should ensure that the Register of Security Interests is updated with the particulars of the security over the Secured LP Interest to ensure that third parties viewing the register are put on notice of such security.

Security filings by the chargor

Where a chargor has created a security interest over the Secured LP Interest, the chargor may need to make security filings and/or updates to its internal register of charges (or equivalent) in accordance with the laws and regulations of the chargor's jurisdiction of incorporation or residence. The chargor will typically be required to deliver a copy of such filing and/or internal register as deliverables under the security document (if applicable).

Governing law of security document

Cayman Islands law

Cayman Islands law permits the security document to be governed by either Cayman Islands law or foreign law.

The security document is most often governed by Cayman Islands law, however, this may vary depending on (i) the commercial agreement between the parties; and (ii) market practice within the regional context of the transaction. Where foreign law security is being taken over the Secured LP Interest, the security document will still need to include the relevant Cayman-specific provisions.

Remedies available

If a default occurs under a Cayman Islands law security document, the chargee may:

- (subject to the terms of the security document and the LP Agreement) sell the Secured LP Interest;
- appoint a receiver in respect of the Secured LP Interest who may (subject to the terms of the security document and the LP Agreement):
 - receive distributions in respect of the Secured LP Interest; and
 - exercise any other rights and powers of the chargor in respect of the Secured LP Interest.

The chargee may exercise the power to sell, and the right to appoint a receiver in respect of the Secured LP Interest without obtaining a court order.

Application of proceeds on enforcement

Unless the security document states otherwise, the proceeds of enforcement of the security will be applied in the following order of priority:

- **first** in paying the enforcement costs;
- **second** in paying the sums secured by the security document; and
- **third** in paying the balance (if any) to the chargor.

Contacts

A full list of contacts specialising in Banking and Finance can be found [here](#).