

FUND FINANCE FRIDAY

Cayman Investor Notices Through the Ages (of Fund Finance)

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As anyone who has ever worked on a subscription-based fund finance facility involving Cayman vehicles can tell you, there will at some point be engagement on the “investor notices.” Most attorneys and bankers in the space can explain why this matter arises (because the Cayman Islands does not have a forum to formally register security interests to establish priority or otherwise), and almost everyone has a view on what is “market standard” *vis-à-vis* the issue of such notices.

The reason for and use of investor notices is an evolving concept, however, and while we don’t anticipate Ken Burns or David Attenborough covering it in a documentary any time soon, a quick trip through the ages of fund finance is helpful to shed some light on what is, from a Cayman Islands perspective, an enduring feature of fund financing transactions.

The Dark Ages – When PE Was Just Two Letters

The root of the issue has its source long before the days of email, Zoom, FOMO or even Downton Abbey. This root is, of course, the English case of *Dearle vs. Hall*, which arose out of a set of transactions dating in the early 1800s. One party (an enterprising gentleman named Zachariah Brown) inherited the right to an annuity payment to be made by a trustee. He then, in return for a payment in each case, assigned his right to such annuity on three subsequent occasions to three different purchasers.

The final party who purchased the rights (Hall) had hired an attorney* who undertook due diligence on the annuity and served notice on the trustee that the assignment had occurred. Neither of the two previous assignees (one of whom was Dearle) had yet done so.

Subsequent to the final assignment and the notice being served by Hall on the trustee, the first two assignees (Dearle and Co.) notified the trustee of their interests and prior assignments. The trustee did what any trustee would do: hit the panic button hard and repeatedly and called in the Courts to help.

In simple terms, the Court held that notwithstanding the date on which the various assignments had occurred, Hall (the final purchaser of the rights in time) had priority to such rights over the two prior assignees as a result of his having first given notice to the trustee.

**Mr. Patten, whom we imagine to be something akin to a Downton Abbey character, gave attorneys a great example to point at when asked how to justify their necessity.*

The Middle Ages – Subscription Finance Emerges

The evolution and growth of the subscription finance industry in the 2010s came at the same time as corresponding growth in the use of Cayman Islands vehicles (particularly, exempted limited partnerships) in private equity structures. While the concept of taking security over contractual rights was not novel in the broader legal context, the issue of cross-border lending using a U.S.-governed security agreement to secure rights established by a Cayman Islands-governed agreement (generally, the exempted limited partnership agreement) was certainly one which merited thought.

Thankfully, salvation was found in the form of *Dearle vs. Hall*, which provided a clear path to establishing priority in respect of a security interest over capital call rights – being notice to the limited partners. This notice, once served on the limited partners, would satisfy the rule in *Dearle vs. Hall* and protect the priority of a lender's security over such rights.

Unfortunately, it wasn't all that simple in practise. The question of how this notice would be served became one which all parties were sensitive to. Lenders and their counsel wanted the best form of notice, being one which was sent immediately on closing and took the form of an independent document sent to limited partners and acknowledged by such limited partners. Borrowers, on the other hand, wanted notice to be included amongst other investor communications, occurring, in some instances, months following closing.

Debate ensued, different lenders had different approaches, and different sponsors had different preferences. For the most part, investor notices were sent as independent documents to investors within 30 days or so, acknowledgement of receipt by limited partners was rarely seen, and the issue was one that was viewed as relatively negotiable by parties.

The Second Coming of Cayman Notices

Every industry has its coming of age moments and, following a high-profile sponsor insolvency, the issue of Cayman notices arrived back on the radar for the industry. Lenders became re-engaged about understanding the details of the issues and risks arising from delays in serving notice.

This led to a second coming of the issue where the market moved significantly towards notice being served as an independent document and within a much shorter timeframe post-closing (anywhere from on the date of closing to 15 days from that date). The days of investor notices being one paragraph in a quarterly report to investors were gone. Thankfully, however, this

happened at a time where limited partners had also become much more familiar, informed and understanding of subscription facilities, and so, in many cases, sponsors were already “over” the issue and less sensitive to communications on the point raising queries in their investor base.

The position today is largely unchanged and generates a certain amount of paper tracing (with executed notices and evidence of sending being provided by borrowers post-closing) but relatively little debate.

The Roaring 2020s – What’s Next?

While the current formula works, nothing is ever perfect. The future of investor notices certainly lies in technology and, as the industry continues to evolve and develop, we can see a scenario whereby a party (or group of parties) form a more efficient system to serve the industry in this regard.

The other trend to watch is whether this modern Cayman phenomenon (with its roots in the 1800s) takes flight and becomes a feature in other jurisdictions where, although perhaps not a technical legal requirement, it is sought as a type of additional lender check and comfort. Watch this space!