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Fund Finance Friday

Re-member Where the Register Is! Why the Location of the Cayman Register of Members Is Relevant to a Lender's Security Package

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As we are moving further into the realm of Fund Finance 2.0 and the rise of the NAV facility, there has been a lot written about taking security over the equities of various types of Cayman entities, particularly Cayman exempted limited partnerships and Cayman exempted companies ("CayCos"). Here we look at additional considerations when taking security over shares in a CayCo ("Cayco Security") in cases where the register of members ("ROM") is maintained in a jurisdiction other than the Cayman Islands or the United States (a "Third-Party Jurisdiction").

What is the relevance of the location of the ROM?

To set the scene:

- One quirk of Cayman law is that the ROM is (in most circumstances) definitive of share ownership.
- Another quirk is that the ROM does not have to be maintained in the Cayman Islands. Most commonly, the ROM is (i) maintained by the registered office or an administrator within Cayman or (ii) maintained by an administrator in the U.S. (we will refer to any entity that maintains a ROM as an "Administrator" for the purpose of the article). With the continual growth of the fund finance market and the diversification of fund structures and borrowers, however, we are increasingly seeing ROMs maintained by Administrators in Third-Party Jurisdictions (a "TPJA").
- Cayco Security is usually governed either by Cayman law, or in the context of a wider U.S. law transaction, the applicable U.S. law (usually New York.)
- In an enforcement situation, to effect a share transfer the ROM must be updated by the Administrator to reflect the secured party (or its nominee) as the shareholder.

The combination of the above points means that a secured party could end up in a situation where it has a Cayco Security governed by Cayman or U.S. law but needs to take that security to a TPJA to have the ROM updated to effect a share transfer upon enforcement. The question then arises: can the secured party be confident that the share transfer would take place in a timely manner? Will the TPJA respect and follow the share transfer instructions in relation to an enforcement action?[1]

In addition to the practical aspects of enforcing Cayco Security in a Third-Party Jurisdiction, there is a fundamental legal question as to the applicable governing law of the security in the case of Cayman shares where the ROM is held in a Third-Party Jurisdiction. As a general rule, the law of the place of incorporation of a company (in this case, Cayman) decides how the shares in a company may be transferred; given that shares in a CayCo can only be transferred by registration on the ROM, those shares will generally be regarded as situate at the place where the ROM is maintained. Why does situs matter? Although the position is not entirely free from doubt, the more commonly held view is that situs determines the proprietary aspects of a security interest (that is, the steps required to perfect a security interest in the Cayman shares). We could go into a much longer analysis as to the applicable governing law of CayCo shares where we have a TPJA, but for the purpose of this article, it is just worth noting that, from a legal and governing law perspective, the Third-Party Jurisdiction of the ROM should always be considered and that, in some cases, additional local law actions might be required in the Third-Party Jurisdiction (for example, additional local law perfection steps).

The various approaches to a TPJA

Whether any additional steps should be taken when a ROM is maintained by a TPJA will depend on a number of factors, including the Third-Party Jurisdiction, the relationship between the applicable parties (*i.e.*, the lender, borrower and pledged entity), the TPJA's understanding of Cayman security and familiarity with the jurisdiction, and the commercial agreement between the parties as to the risk analysis in the event that parties end up in an enforcement situation. We have seen varying levels of additional lender protections, from no additional action being taken through to additional perfection steps in the Third-Party Jurisdiction and even additional local law security being taken in the Third-Party Jurisdiction.

There is no one-size-fits-all approach to addressing these considerations, and we are certainly not suggesting that a TPJA will necessarily cause issues for a transaction or cannot work from a secured party perspective. But it is something to be mindful of, particularly as we see increasing numbers of more unusual fund structures. We would recommend seeking input from local counsel in the Third-Party Jurisdiction, particularly as to whether any additional perfection steps might be required.

Cayman security is generally a well-trodden path, but there are certainly quirks and considerations that will come to the forefront as the borrowers and fund structures continue to diversify and also as new lenders enter the market with fresh eyes and often new approaches to risk profiles. We look forward to providing ongoing updates as to new commercial trends and considerations that we are seeing as the market continues to develop.

[1] Just to highlight that we are not generally concerned with any combination of Cayman/U.S. law governed CayCo Security and Cayman or U.S. Administrators − these jurisdictions work well together, are familiar to each other and there is a history of these structures being effectively enforced between the jurisdictions.