

Fund Finance Friday



Fund Finance: Cayman Private Funds Law — To Covenant or Not To Covenant?

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The Private Funds Law, 2020 of the Cayman Islands (the Law) came into effect on 7 February 2020 and heralded a new regime for the registration of certain closed-ended funds (Funds) with the Cayman Islands Monetary Authority (CIMA). The advent of the Law has led to discussion on whether to include an express covenant and event of default (or any other related provisions, such as conditions precedent and subsequent) relating to the Law into credit agreements.

The Law

Existing Funds and those Funds launched between 7 February 2020 and 6 August 2020 have until 7 August 2020 to register with CIMA (the Transitional Period). All Funds created prior to or during the Transitional Period are required to be registered with CIMA if they have previously received capital contributions from investors for investment purposes or in order to receive such capital contributions after the Transitional Period. From 7 August 2020, all new Funds have 21 days after the acceptance of capital commitments from investors in which to register with CIMA before being able to receive capital contributions "for the purposes of investments."

It is nuanced, but there is a perceived risk (open to interpretation) were a lender to seek to enforce their security after the Transitional Period but prior to a Fund being registered that either: (i) an investor could seek to use the fact that the Fund is not registered as a reason to delay funding a capital call (this point may become more acute if investors start to suffer from liquidity issues due to the current COVID-19 crisis – see below) on the basis that it may not technically be in compliance with the Law, or (ii) a contribution from investors to discharge debt owed to a lender may be deemed unenforceable as the original debt was used by the Fund "for the purposes of investments" (and in order to accept such a contribution the Fund needs to be registered under the Law).

To covenant or not to covenant?

Cayman Islands counsel are working with sponsors to analyse which of their entities are within the scope of the Law and to register in-scope Funds by 7 August 2020. Lenders seeking to reduce the potential for argument about the enforceability of their security to call capital are closely examining the traditional compliance with laws and affirmative

covenants in their credit agreements alongside the event of default mechanics. Dependent on the structure of the Fund concerned and the nature and number of the Funds' investors, below are the options:

- change nothing – existing compliance with laws covenants, such as those found in APLMA, LMA or LSTA loan agreements, are often broad and robust and would cover the compliance with the Law. The related event of default usually contains a cure period offering the Fund the time to register with CIMA. This has generally been the approach adopted in the Asian markets to date; or
- have an express affirmative covenant and related event of default provision on the Law – in so doing, the parties are focused on ensuring registration and any risk security that could be deemed unenforceable falls away.

Alternatively, evidence of registration with CIMA could be included as an additional condition precedent to funding or a condition subsequent (to be satisfied within a certain number of days prior to the end of the Transitional Period), which are potentially more commercially palatable solutions than negotiating the covenant and event of default options.

COVID-19 a factor?

Upon the Law coming into effect, commentators noted the evolving use in certain markets of express covenants and events of default with generous cure periods of up to 30 days for breach of the Law. In addition, evidence of registration in a form acceptable to the lender was, in general, requested to be provided in reasonable time post-registration.

In recent days, lender appetite is evolving in line with the mounting concern over the international economic environment. Cure periods are ebbing away rapidly and evidence of registration of Funds is being sought between 15 to 30 days ahead of the 7 August 2020 deadline for registration under the Law. Some lenders are advocating for immediate events of default for non-registration and deeming such non-registration as a material adverse event. In addition, lenders are requesting they receive copies of any notice issued by CIMA in relation to any breach of the Funds' registration terms under the Law.

Conclusion

The position of lenders and sponsors on the point is fast evolving in line with the changing economic landscape. The expectation is that, from 7 August 2020, all new Funds will register at launch, and we may therefore see the express covenant and event of default wording relating to the Law relax again, with only the requirement for evidence of registration from CIMA on or promptly after closing remaining.