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Cayman Private Funds Law — Drafting Issues and Implications

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On February 7, 2020, the Cayman Islands Private Funds Law, 2020 (the “PF Law”) came into effect, requiring certain closed-ended Cayman-domiciled funds (“Funds”) to register with the Cayman Islands Monetary Authority (“CIMA”) by August 7, 2020.

With the August 7 deadline fast approaching, Lenders are increasingly seeking the inclusion of language to safeguard the enforceability of their security, and there is certainly no shortage of negotiation involved in this process.

While we have seen various *Fund Finance Friday* articles from Cayman counsel on the new PF Law itself, this article focuses on drafting concerns and mechanics in subscription credit facilities, and the implications for Lenders and Funds alike.

Drafting Issues and Implications

If a Fund has not registered by the deadline, that Fund will not be able to accept capital contributions for the purpose of investments, and in that vein, a contribution for the repayment for indebtedness to a Lender may be similarly captured, potentially rendering the Lender’s security interest unenforceable.

The inclusion of affirmative covenants and corresponding event-of-default provisions provide Lenders comfort that Funds will undergo registration in compliance with the PF Law. One such example is registration by the date that is 30 days before August 7, with failure to comply being an immediate event of default under the credit agreement.

There is no immaculate formula for determining the appropriate timeframe for registration; however, 30 to 60 days is often the starting point for any healthy negotiation, and many Lenders have updated their form credit agreements accordingly. Practically speaking, at least a 30-day lead-in provides sufficient time for Lenders to either step in or require the Fund to call capital at least twice to repay the facility, as a remedy to the default.

While counsel on the Fund side may argue that existing covenants as to compliance with law are sufficient to capture the requirements under the PF Law, without a buffering period, Lenders are faced with the possible challenge of being prevented as a matter of law from receiving capital calls necessary to make whole their loan commitment post-August 7.

A well-informed LP may have reservations towards meeting a capital call for the repayment of debt due to failure to comply with the PF Law. If the LP withholds its contribution, after August 7, the Fund may in any case be barred from accepting such contribution. Taking into consideration the average notice requirement under the Fund’s limited partnership agreement for responding to a capital call, and the time required for a bank to initiate remedies after an event of default (including giving effect to any negotiated capital call standstill period), 30 days is by no means a panacea, but at the very least provides a reasonable amount of time to initiate an appropriate solution.

What next?

At this point, there is no indication that the registration deadline will be pushed back as a result of the coronavirus pandemic. As the deadline approaches, this will require counsel to revisit the mechanics of credit agreements in order to continue minimizing risks to Lenders' collateral. We may begin to see registration with CIMA becoming a condition precedent to drawdown, with evidence of registration and ongoing maintenance becoming a requirement akin to the provision of certificates of good standing. Another solution we have seen proposed is requiring a full mandatory prepayment if registration does not occur 30 days prior to the deadline.

With financial penalties in play for noncompliance, and the ultimate consequence being the inability to accept capital contributions for the purposes of investments, both Lenders' and Funds' interests are very much aligned when it comes to the PF Law: Funds captured under the law must register ahead of the deadline.