Practice Note on the New Cayman Island’s Beneficial Ownership Regime

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What Is The New Beneficial Ownership Regime?

Under recently passed legislation (the “Regime”), Cayman Islands companies and Cayman Islands limited liability companies (“LLCs”) are now required, unless an applicable exemption applies, to maintain a beneficial ownership register that records details of the individuals who ultimately own or control more than 25% of the equity interests or voting rights of the company or LLC or who have, directly or indirectly, rights to appoint or remove a majority of the company directors or LLC managers. The register is also required to include details of certain intermediate holding companies through which such company or LLC interests are held.

The new Regime codifies a commitment agreed upon between the Cayman Islands and the United Kingdom to enhance existing, robust arrangements on the exchange of beneficial ownership information to assist law enforcement agencies in combating tax evasion, money laundering and the financing of criminal enterprises.

Whilst there are specified exemptions to the Regime (which broadly seek to exempt those entities already subject to a certain level of regulatory oversight), those companies and LLCs that fall within the Regime’s ambit (each, an “In-Scope Entity”) will be required to maintain a beneficial ownership register. Each In-Scope Entity is required to take “reasonable steps” to identify certain information including whether there is any individual who qualifies as a beneficial owner under the Regime and whether any legal entities that are registered in the Cayman Islands (including foreign companies) would meet the definition of a beneficial owner if they were an individual.

Why Is It Important to Fund Finance Market Participants?

It is important for lenders in any financing transaction to assess the relevance of the new Regime to the transaction, and in particular, the potential impact of the issuance of a restrictions notice by an In-Scope Entity (which may well be downstream of the borrower and obligor parties). A restrictions notice may be issued by an In-Scope Entity to its equity holder (the “Equity Holder”) when certain information regarding the ownership or control of the company share or LLC interest (the “Interest”) that the In-Scope Entity is entitled (and, indeed, required) to obtain from the Equity Holder has not been provided. Failure to provide such information is also a breach of law by the Equity Holder (even where that Equity Holder is otherwise exempt from the Regime) and, accordingly, it follows that a restrictions notice can only be served in circumstances where there has been a breach of law by the Equity Holder.

Once a restrictions notice has been issued, it is important to be aware that its effect goes beyond simply a restriction on transfer of the Interest in respect of which it has been issued.

Where a restrictions notice has been issued in respect of an Interest, any transfer or agreement to transfer the Interest is void, no rights are exercisable in respect of the Interest, no shares may be issued (in the case of a company) or additional rights granted (in the case of an LLC) in respect of the Interest or in pursuance of an offer made to the Interest-holder, no payment may be made of sums due from the In-Scope Entity in respect of the Interest, whether in respect of capital or otherwise, and (other than in a liquidation) an
agreement to transfer any of the following associated rights in relation to the Interest is also void: (a) a right to be issued with any shares (in the case of a company) or granted additional rights (in the case of an LLC) in respect of the Interest; or (b) a right to receive payment of any sums due from the In-Scope Entity in respect of the relevant interest.

One important point to note in the context of fund financing transactions is that a restrictions notice can never be issued in relation to limited partnership interests in a Cayman Islands partnership (as the Regime applies only to companies and LLCs), nor will any restrictions notice (or its impact) apply to or otherwise impinge upon any capital call rights attaching to those limited partnership interests. As such, the enforceability of the main collateral package in subscription financing transactions should not be affected by the Regime.

However, it is clear that the issuance of any restrictions notice has far reaching and potentially significant importance in a financing transaction, if, for example, an Interest its subject to a security interest (for example, in a portfolio company financing where the fund incorporates a Cayman Islands company to borrow money for investment and the shares in that new company are secured in favour of the lender) or if the transaction documents reference or otherwise capture any rights, interests or obligations relating to an Interest, for example, by virtue of collateralization tests or borrowing base thresholds (for example, in any net asset value or asset-backed facilities where the underlying securities owned by the fund could include Interests or rights relating to Interests, that are subject to security granted in favour of the lender).

How Can Parties Address the Beneficial Ownership Regime?

The good news for lenders is that, under the Regime, no restrictions notice can be served in respect of any Interest where such Interest is subject to a security interest granted to a third party who is not affiliated with the person holding such Interests and, should any such restrictions notice be inadvertently served, there is a process for setting it aside. More broadly, there is also a process for any “aggrieved” third party to apply to have a restrictions notice set aside where the Court is satisfied that a restrictions notice is unfairly restricting the rights of the third party.

This will, in practice, reduce the risk to lenders in any secured transaction given that there is unlikely to be an affiliation between the fund borrowers and the lending institution.

It is also worthwhile to note that regulated investment funds (and those funds operated or managed by regulated managers) will be outside the scope of the Regime and Interests of those regulated investment funds will therefore not be capable of being subject to any form of restrictions notice.

However, parties in unsecured and corporate transactions will need to closely consider the assets involved in the transaction, and will need to place significantly greater reliance on the representations, warranties and undertakings contained in the transaction documents. In particular the transaction provisions relating to continuing compliance with all applicable laws will need to be scrutinized to confirm that they adequately address any concerns related to the Regime (an Equity Holder in full compliance with the Regime cannot have been issued a restrictions notice). Lenders and, indeed, counterparties generally, will want to ensure that they are as protected as possible and easily able to enforce their security interests. To that end, lenders will want to consider what actions a fund borrower is required to undertake under the transaction documents to address the Regime and restrictions notices, particularly at the time of enforcement. We are regularly working with funds, lenders and other counterparties to ensure that the transaction documents properly address the potential issues raised by the Regime.