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Private equity and Cayman Islands funds: tips, trends and pitfalls for limited partners

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Changes to private funds legislation in the Cayman Islands and a growing investor demand for environmental, social and governance (**ESG**) investing are throwing up new issues for limited partners (**LPs**) looking to commit capital in Cayman structures. In this Q&A, funds and private equity specialists Joanne Huckle and Barry McEwan discuss the trends and common pitfalls.

Are you seeing more LPs wishing to instruct Cayman counsel before committing capital, and why?

It is surprising that investors making a significant investment haven't always taken their own Cayman Islands counsel prior to committing capital. They have sometimes relied on fund counsel (despite clear disclosures in offering documents that the fund counsel doesn't represent the investors individually).

It may also be that there is increased regulatory oversight of Cayman Islands funds resulting from the 2020 Private Funds Act coupled with the more prescriptive rules issued last summer by the Cayman Islands regulator, CIMA, as to the contents of offering documents, segregation of assets and calculation of net asset values, so institutional investors are now looking for more comfort that the fund will be in regulatory compliance. This trend is reinforced by the potential for substantial administrative fines to be imposed upon the fund by CIMA for breaches of prescribed provisions of certain Cayman laws and regulations including the Private Funds Act and the Anti-Money Laundering Regulations.

In particular, we are seeing European investors seeking Cayman counsel on the investor side and we work in close contact with our offices in Luxembourg, London and the Channel Islands if appropriate.

What sort of issues do you see and how does your advisory service assist LPs?

Every transaction is different. We offer clients either a "deep-dive" review and diligence on the commercial and legal documentation that have been provided by the fund or a higher level, red flag legal review. In both cases, it helps ensure the LP is making its investment with its eyes wide open. In the deeper dive we are looking at anything off market in the limited partnership agreement (**LPA**) that may be too sponsor-friendly or where it may be possible to improve the investor's position, based on the extensive private equity fund launch work we do. With respect to the legal aspects of our review, LPs that have traditionally invested in US or European structures may be less familiar with the inner mechanics of fund LPAs and other fund documentation or less familiar with Cayman specific issues and so we guide them through these.

The issues identified vary from deal to deal, but for example we have seen a fund that essentially had no end date as there was a never ending option for the general partner (**GP**) to extend the term; we have seen LPAs which include extremely off-market interest rates for defaulting partners; and we even saw one fund that had inadvertently missed a number of core regulatory filings and registration.

Other examples of provisions we have identified resulting in successful LP negotiating include provisions regarding expenses, indemnification and exculpation, distribution clawback rights (which we successfully narrowed), carried interest clawback protections, distributions in kind, term extensions, impact of defaulting limited partner on non-defaulting limited partners.

Are there any common pitfalls LPs can easily avoid when investing into a Cayman fund?

Investors tend to be focused on a myriad of issues depending on their own investing mandate, background, sector and geographical interests and we tailor our service accordingly. Having said that, not dissecting the regulatory compliance of the fund, that there is a qualifying general partner of any Cayman partnership, that the limited liability of LPs is not jeopardized by the fund documentation drafting, confidentiality and information inspection rights, investor voting rights/limitations, LPA amendment provisions, GP removal, waterfall provisions and advisory committee powers would be among some of the more common pitfalls for LPs and the areas we most commonly negotiate on behalf of our LP clients.

Any other trends you have seen?

It would be remiss not to note the uptick in focus on ESG issues. In this regard, we have seen a growing number of investors seeking acknowledgment and agreement from the GP to the investor's binding ESG policies and to take into account such policies when making investment recommendations or decisions. We have seen a marked increase in desire by LPs to ensure exactly how the fund's investment process, systems and staff support the identification of ESG factors that may be material to any investment. In 2020, Ogier launched the Ogier Global ESG and Impact advisory service in response to increasing demand in this area.

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