

BRIEFING NOTE

Cayman Islands Private Equity Funds and the use of Exempted Limited Partnerships

Structure of Cayman Private Equity Funds

The most common structure for a Cayman Islands domiciled private equity fund (“**PE Fund**”) is as an exempted limited partnership (“**ELP**”) formed under the Exempted Limited Partnership Law (As Revised) (“**ELP Law**”). However there are some Fund sponsors who choose a Cayman exempted company rather than an ELP as the corporate structure for their PE Funds for a number of reasons, including, onshore tax or regulatory considerations, or the investor base are more familiar with or prefer to invest in a Cayman exempted company.

The ELP is required to have a general partner (“**GP**”) which is most commonly a Cayman exempted company. However a foreign company (e.g. a limited liability company) has been able to be the GP of an ELP upon registration as a foreign company in the Cayman Islands. A partnership established outside the Cayman Islands was not previously able to act as a GP of an ELP. The list of persons who qualify as a GP of an ELP has been extended to include a limited partnership or limited liability partnership established in a recognized jurisdiction (e.g. United States, United Kingdom, Hong Kong, BVI, Singapore, Jersey, Luxembourg) (a “**foreign limited partnership**”) provided such foreign limited partnership is registered as a foreign limited partnership in the Cayman Islands.

The GP is responsible for conducting the management of the affairs of the ELP and is ultimately liable for all debts and obligations of the ELP to the extent that the ELP has insufficient assets. The GP will sign all contracts on behalf of and in the name of the ELP.

The Directors and shareholders of the GP are typically persons who are affiliated with the sponsor of the PE Fund. There is no requirement for any Director or shareholder of the GP to reside in the Cayman Islands. The limited partners of the ELP will be the investors subscribing for equity interests in the PE Fund. There are no restrictions on the number of investors that may be admitted to an ELP. There is no requirement for any limited partner of the ELP to reside in the Cayman Islands.

Main Features of the ELP

The ELP Law adopts principles similar to those found in the Delaware Revised Uniform Limited Partnership Act, and this similarity with the Delaware model makes the ELP particularly attractive to managers and investors in the United States. However, unlike a Delaware limited partnership, an ELP does not have a legal personality of its own. The ELP is a legal arrangement between its GP and its limited partners and the terms of this legal arrangement is governed principally by the terms of the limited partnership agreement (“LPA”). The contractual rights and equitable interests in the assets of the ELP are held on trust for the ELP by its GP (and, if there is more than one GP, by the general partners jointly)

Not having its own legal personality, the ELP is generally regarded from an onshore tax perspective as being tax transparent (or as having "see-through", "look-through" or "flow-through" status, which signify the same thing) with the effect that the ELP itself will not be liable to any onshore taxes, and value distributed by it will "flow-through" to the investors (and may be subject to local taxes in their hands).

A limited partner may not participate in the conduct of the ELP's business, and all contractual documents and papers must be executed by the GP as the contracting party acting on behalf of the ELP. Any limited partner participating in this way, as though it were a GP, will be liable for the debts and obligations of the ELP, if it goes insolvent, to any person transacting business with the ELP through the limited partner and who had actual knowledge of such limited partner's participation and who reasonably believed that limited partner to be a general partner.

The ELP Law set out certain non-exhaustive "safe harbours" of activities in which a limited partner may engage without risk of losing its limited liability status; a limited partner's participation on an advisory board or investment committee of the PE Fund will typically be within the safe harbours. The LPA may nonetheless provide for any amount of limited partner participation in the conduct of the ELP's business.

Under the previous ELP law, a GP was under an absolute duty to act in good faith in the interest of the ELP. This duty could not be restricted, limited or varied by the terms of the LPA between the GP and the LPs. The requirement to act in the interest of the ELP often raised the issue of conflicts of interest for the GP, particularly when it acted as GP to more than one ELP. A GP which acted as the sole GP to several private equity funds (structured as ELPs) had to, for example, consider how to discharge its statutory duty to act in good faith in the interest of each fund, in relation to investment opportunities. The ELP Law, which came into force on 2nd July 2014 with the aim of enhancing the attractiveness of the Cayman Islands as the leading offshore jurisdiction for private equity funds, retained the absolute duty on the GP to act in good faith. However, whilst retaining the duty on the GP to act in the interest of the ELP, makes it subject to any express provision in the LPA to the contrary.

A limited partner of an ELP owes no fiduciary duty to any other partners of the ELP or to the ELP itself in exercising any of its rights or performing any of its obligations under the LPA, except to the extent that it has expressly agreed to such fiduciary obligations in the LPA. Partners may nevertheless agree to set out certain fiduciary obligations in the LPA. They might,

for example, agree to impose fiduciary duties on members of advisory boards or committees of the ELP.

Regulation

As a general matter, closed-ended funds (e.g. a private equity fund or a real estate fund), however structured, are not regulated by the Cayman Islands Monetary Authority (“**CIMA**”) under the Mutual Funds Law (2015 Revision) because the equity interests issued by the ELP are not redeemable or repurchaseable at the option of investors. In addition, the PE Fund's GP does not require any form of approval or licensing in the Cayman Islands.

Timing

Formation and registration of an ELP and its GP can take place either on a same-day express basis with the payment of an express fee of approximately US\$488 or within 2-3 business days on a standard basis.

Taxation

There are no capital gains, income, withholding, estate or inheritance taxes in the Cayman Islands. The ELP can apply for (and can expect to obtain) an undertaking from the Cayman Islands government that no form of taxation that may be introduced in the Cayman Islands will apply to the ELP for a period of 50 years from the undertaking being given. The GP can also apply for (and can expect to obtain) an undertaking from the Cayman Islands government that no form of taxation that may be introduced in the Cayman Islands will apply to the GP for a period of 20 years from the undertaking being given.

This Briefing Note is not intended to be a substitute for specific legal advice or a legal opinion. It deals in broad terms only and is intended to merely provide a brief overview and general guidance only. For more specific advice on the Cayman Islands companies, please refer to your usual Loeb Smith contact or:

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