



How do creditors take security over limited partnership interests in a Cayman Islands exempted limited partnership?

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Introduction

Exempted limited partnerships (“**ELPs**”) are a form of Cayman Islands partnership which are commonly used in investment fund structures, particularly closed-ended private investment funds. This can be contrasted with open-ended mutual funds which are typically structured using a Cayman Islands exempted company.

There are a broad number of funding arrangements available to Cayman Islands investment funds and also to investors in them. For example, a fund which holds investments through an ELP as a holding vehicle may obtain debt finance from either a bank or private credit institution which is linked to the net asset value (NAV) of the fund and in exchange, the lender takes collateral over interests in the ELP that holds the fund’s investments.

Funding is also available to investors in Cayman Islands funds which will borrow to fund their capital contributions, and the lender will take collateral over the investor’s interest in the fund.

Taking collateral is straightforward where the interests being charged are shares in a typical limited liability company (such as a Cayman Islands exempted company) as that takes the form of a conventional charge over shares with supporting ancillary documents. This article explores the less well-known method of taking security over a limited partner’s interest in an ELP.

This is the first in a series of two articles. In the next article, we will consider other types of finance that are available to ELPs as well as the method of taking security over the assets of an ELP.

Limited Partner Interests

An investor in a fund that is structured as an ELP is issued with limited partnership interests (“**LP Interests**”) in exchange for their capital contributions. The general partner of an ELP (“**General Partner**”) is required to maintain a register of partnership interests containing certain prescribed information in respect of each limited partner (“**Register**”).

Creating security over LP Interests

Before a lender takes security over LP Interests, it must first undertake detailed due diligence in order to ensure that the security that is available matches its expectations.

First, it should review the relevant provisions of the limited partnership agreement relating to the ELP (“**LPA**”). LPAs usually contain either an outright prohibition on the creation of security over LP Interests or in the very least require the prior written approval of the General Partner to the creation and subsistence of the security. There is often no express contractual requirement for the General Partner to not ‘unreasonably withhold or delay consent’. Therefore, early and transparent engagement with the General Partner is essential.

A further consent may be required from the General Partner as LPAs also typically restrict the transfer of LP Interests without the General Partner’s consent. A lender will therefore wish to obtain consent upfront to any transfer of title in the relevant LP Interests in the event that the security is enforced.

In addition to reviewing the LPA, a well-advised lender will also insist on reviewing any side letters and the subscription application that may have been entered into by the limited partner with the ELP to ensure that the provisions to the LPA dealing with the creation of security have not been modified. To the extent that a side letter does not exist, the lender should obtain representations and warranties to this effect from the limited partner in the finance documents.

Finally, the lender should also review the Register (to ensure that the security provider does in fact hold title to the LP Interests that are to be the subject of the security) and, in the case of a corporate security provider, its register of security interests to ensure that no prior security interests subsist over the LP Interests. To the extent that any security interests are revealed to already exist, the prior security interests will need to be redeemed prior to concluding the funding. Alternatively, a deed of priority or intercreditor deed could be entered into with the other secured party.

In addition to legal due diligence, the lender should also make enquiries of the ELPs records of capital contributions to ensure that any and all capital commitments have been fully funded (or will be so funded with the financing to be provided).

The security document

Under Cayman Islands law, there are no prescribed particulars for how security over LP Interests is created and perfected. That said, the security document that will be entered into to create security over the LP Interests follows a format that will be familiar in finance transactions in other jurisdictions. In particular, the security document will:

- be in writing;
- be signed by the limited partner granting the security (usually as a deed);
- contain a full and detailed description of the LP Interests that will be the subject of the security. In addition to the LP Interests themselves, the security created will also extend to all 'related rights' to the LP Interests, such as rights to any distributions and the ultimate return of the invested principal;
- contain details of the amount to be secured by the document. Typically, this will not be a specific monetary amount but will instead be expressed to be either 'all monies owing by the limited partner to the lender', or 'all monies owing by the limited partner to the lender under the finance documents'; and
- specify the powers and entitlements of the lender in the event of a default by the limited partner which results in the security becoming enforceable. The events of default themselves will typically be listed in the accompanying facility letter or loan agreement.

In addition to the security document, a limited partner providing security will also provide the required consent(s) from the General Partner (as noted above) and a signed, undated instrument of transfer relating to the secured LP Interests, with the transferee left blank. Any enforcement transfer remains subject to the transfer restrictions contained in the LPA and the terms of the security document.

Registrations, filings and taxes

A person granting security over LP Interests is required to provide written notice of the creation of the security to the ELP at its registered office. Such notice must specify the agreement pursuant to which security is granted, including its date, the names of the parties and details of the LP Interests that are the subject of security.

In practice, a well-advised lender will insist on the chargor having dialogue with the ELP prior to conclusion of the financing so that the form of notice is agreed in advance and promptly served. As between competing security interests over the same LP Interests, priority is determined by the time at which written notice of the security is received at the ELP's registered office. The ELP is required to maintain a register of security interests in respect of each such notice that it receives.

The lender will also typically require a written acknowledgement from the ELP as confirmation this requirement has been met as well as a copy of the duly completed register (or an extract therefrom).

If the limited partner providing the security is itself a corporate entity or an ELP, depending on its jurisdiction of incorporation it may need to make filings and update registers of its own in order to remain compliant and to ensure the security remains valid and enforceable.

No stamp or other taxes are typically payable in respect of either the grant of security over LP Interests or any subsequent transfer of LP Interests where the security is enforced save where the document is executed in, or brought into, the Cayman Islands.

Enforcement of security

In the event of a continuing default by the chargor, the holder of the security over the LP Interests may enforce it in accordance with the terms of the security document. Security documents will usually permit the securityholder to sell the charged LP Interests or appoint a receiver in respect of the same.

However, the securityholder's rights under the security documents are only part of the overall analysis. Well-advised lenders should, from the outset of the financing, carefully review whether the terms of the LPA adequately accommodate an enforcement scenario and, where necessary, seek appropriate amendments or consents.

LPAs are commonly drafted so as to restrict the transfer of LP Interests without the consent of the General Partner. A secured creditor will therefore typically require either: (i) the General Partner's advance consent to transfers arising upon enforcement of the security; or (ii) sufficiently broad provisions within the LPA itself permitting transfers of LP Interests by a secured creditor or receiver on enforcement.

This issue is particularly important because, in an enforcement scenario, the General Partner may not necessarily take a position aligned with the interests of the lender. Lenders will therefore wish to ensure that the LPA does not confer overly broad discretion on the General Partner in a manner that could frustrate or materially delay the enforcement process.

This publication is not intended to be a substitute for specific legal advice or a legal opinion. For specific legal advice on the subject matter of this Briefing, please contact:

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