

FUND FINANCE FRIDAY

One (Cayman Corporate Governance) Rule to Rule Them All ...

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The growth in regulation and oversight of private equity and venture capital funds (“Private Funds”) in the Cayman Islands has again taken a step forward with the recent introduction by the Cayman Islands Monetary Authority (“CIMA”) of the Statement of Guidance on Corporate Governance for Mutual Funds and Private Funds (the “Corporate Governance Guidance”). To date, only Cayman mutual funds (being open-ended funds or “hedge funds”) were in-scope of such guidance and, while Cayman Private Funds were of course subject to the Private Funds Act and the regulations stemming from it, they have not been subject to specific guidance from CIMA in respect of how their funds and structures should operate from a governance perspective.

The introduction and expansion of scope of the Corporate Governance Guidance now creates one rule on corporate governance to govern them all (and by them we mean Cayman Islands funds!) and, while we don’t anticipate a three-part Lord of the Rings trilogy to explain the consequences, we thought it would be useful for industry participants to have a quick cheat sheet on its effects (hint: it doesn’t make you go crazy with power!).

The short form update – does it matter to lenders?

The inclusion of Private Funds within the scope of the Corporate Governance Guidance will not have a material impact on deal documentation or conditions precedent to the effectiveness of

subscription finance facilities (as opposed to the Private Funds Act, which, of course, did move the needle in both of these areas):

- **From a sponsor's perspective**, it will of course give cause for most to revisit the governance model of their funds and potentially make changes to fit the size and complexity of a structure, but it is unlikely that much change will be required for many sponsors given that the Cayman market is mostly comprised of vehicles managed by the largest and most sophisticated managers in the world.
- **From a lender's perspective**, the regulatory enhancements introduce a modern corporate governance framework for Private Funds that are party to their facilities and so provide some additional comfort (rather than concern) in respect of credit counterparties that are Cayman domiciled.

I'm having a slow Friday – tell me more about what the Corporate Governance Guidance actually requires from Private Funds.

The Corporate Governance Guidance documents various obligations of a fund “Operator,” which is defined as the governing body of a Private Fund – the Board of Directors of a corporation; the General Partner of a partnership; the Manager(s) of a limited liability company; and the Trustee where the entity is a trust.

There are seven principal areas on which the Corporate Governance Guidance is focused:

1. **The oversight function of fund Operators.** Operators of Private Funds are responsible for the activities of the fund. The Operators should comprise members with an appropriate diversity of skills, experience and expertise to ensure overall competence of the Operator. The job of the Operator includes taking steps to ensure that the Private Fund is conducting its affairs in accordance with all applicable acts, regulations and regulatory measures of the Cayman Islands.
2. **Conflicts of interest.** The Operators should have a written conflicts of interest policy commensurate with the size, complexity, structure, nature of business and risk profile of the business operations of the fund. The Operator will be expected to identify, disclose, monitor and manage all conflicts of interest. Additionally, all conflicts of interest should be disclosed at least on an annual basis.
3. **Operator meetings.** Operators should convene a meeting at least once per annum. However, the size, complexity structure and risk profile of the fund may dictate that the Operator meets more frequently.
4. **Duties of Operators.** The Corporate Governance Guidance imposes a number of duties on the Operators of Private Funds. The following are an example of some of these duties:
 - Operators should exercise independent judgment whilst always acting in the best interests of the Private Fund;
 - Operators should act honestly and in good faith;
 - Operators need to regularly confirm that the investment manager is operating within their investment strategy, criteria and restrictions;

- Operators need to keep abreast of the financial position, net asset value and calculation thereof.
5. **Documentation.** The Operator is responsible for ensuring that an accurate written record is kept of all meetings and determinations with respect to the Private Fund.
 6. **Relations with CIMA.** The Operator should conduct the affairs of the Private Fund with CIMA in a transparent and honest manner. This would include disclosure of any matters that could materially and adversely affect the financial soundness of the Private Fund as well as any non-compliance with applicable acts, regulations and regulatory measures.
 7. **Risk Management.** The Operator should ensure that it provides oversight of the risk management of the Private Fund to ensure that any risks are managed and mitigated.

Conclusion – so it's all positive news?

The Corporate Governance Guidance provides welcome clarity on CIMA's position on the governance of Private Funds. While it is unlikely to materially impact many managers or their governance model, the Corporate Governance Guidance provides additional clarity and comfort to international participants, including LPs and lenders, that Cayman continues to enhance its regulatory framework to fit modern standards. For that reason, it can be seen as a positive development in the market.