

Alert

10 Things You Need To Know About...Utilising a Cayman Islands SPV for asset finance transactions

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Special purpose vehicles (SPVs) are commonly employed in cross-border and structured finance transactions, as well as in asset finance transactions. In the context of asset finance transactions, SPVs can be a particularly useful structuring tool for both owners and financiers. In their most basic form, they offer a way to hold an asset within a corporate structure, providing a degree of separation between the owner and the asset. In more sophisticated financing and leasing transactions, however, it is common to see an “orphan” or “off-balance sheet” structure used, offering a number of additional benefits. Wherever an SPV Structure is required, the stable political climate, flexible corporate regime and established and creditor friendly legal system offered by the Cayman Islands makes it an ideal choice of jurisdiction for establishing the SPV.

1. SPVs are widely used as structuring tools in asset finance transactions.

It is very common in the context of asset finance transactions for an asset (be it a commercial vessel, yacht or aircraft) to be held through a corporate structure, with title to the asset being transferred to an SPV rather than the ultimate beneficiary (whether an individual or a corporation) acquiring the asset directly.

Broadly, one of two types of structures are commonly used for asset owning SPVs:

- “on-balance sheet” SPV structures; and
- “off-balance sheet” or “orphan” SPV structures.

In an “on-balance” sheet SPV structure, the ultimate beneficiary will establish a wholly owned SPV to take ownership of the asset, but will retain direct ownership and control of the SPV itself (and will typically also consolidate the SPV onto the parent’s balance sheet, hence an “on-balance sheet” structure). This means that they will be the parent/shareholder of the SPV and will normally also act as a (in the case of an individual) or provide directors to (in the case of a corporate owner) the SPV directly. On-balance sheet SPVs are often utilised within group structures for accounting, tax and/or administrative purposes, and by high net worth individuals acquiring assets (such as yachts and private jets)

for succession planning purposes, as well as to limit any personal liability arising in respect of the asset.

“Orphan” or “off-balance sheet” SPVs are typically used for secured financing transactions, and may be established by either the owner or the financier depending on the requirements of the transaction. In these orphan structures, the shares in the SPV are held within an “orphan trust” structure by a corporate trustee (rather than directly by the beneficiary/operator) pursuant to a trust structure (either a charitable trust or a STAR trust). In addition, the directors will usually be independent of the ultimate beneficiary, and the SPV will instead utilise the services of professional independent directors. The SPV will be legally separate (or “orphaned”) from the beneficiary/operator and will be independent of the other transaction parties such as financiers. From an accounting perspective, the SPV will not typically form part of either the operator/beneficiary or the financier’s group as neither of these parties will have a direct ownership interest in the SPV, meaning the assets can be held off their respective balance sheets (hence being an “off-balance sheet SPV”).

2. SPVs allow an owner/operator to limit their liability in respect of an asset

Under Cayman Islands law, the SPV will be deemed to have separate legal personality and (absent fraud or wilful default) a shareholder cannot become liable for the acts of a company. There will therefore only be very limited circumstances in which a claimant could look through the SPV to bring a claim in respect of the asset directly against the parent/ultimate beneficiary.

By using an SPV structure in the context of an asset finance transaction, the parties can limit their personal liability in respect of the underlying asset. The operator/beneficial owner of the asset will not hold direct title in the asset, but instead will transfer the asset to the SPV. It is therefore the SPV, and not the beneficiary, acting as counterparty to any agreements and other arrangements in respect of the asset, insulating the beneficiary/operator from any claims which may arise in connection with the ownership of the asset, as any such claims will need to be brought against the SPV as legal owner of the asset.

SPVs are also particularly useful in group structures where they can also be employed to effectively segregate the asset from any other property held by the parent, reducing the risk of the asset being negatively impacted by any actions arising in connection with any of the parent's other property, or vice versa. This is common in shipping structures, where separate SPVs are often established for each vessel within the owner's group to prevent the "sister ship arrest" of one of the owner's vessels for the debt of another vessel.

3. SPV structures give financiers a greater degree of certainty and control over the asset

The SPV will be established solely to hold title to a specific asset, and will therefore be untainted by any other activities undertaken by, or property held by, the owner that could negatively affect the asset or the value of any security provided by the SPV to the financiers in respect of the asset.

An SPV will typically be structured in such a way that, in the event of a default or breach which could impact the value of the asset or of any security provided in respect of the asset, the financier is able to take control of the SPV. This is usually achieved through a charge over the shares of the SPV, which will give the financier the right to transfer the shares in the SPV either to itself or its nominee upon the occurrence of an event of default which is continuing. In an enforcement scenario, this enables the financier to transfer the SPV as a going concern rather than having to arrest and sell the asset (which will often require a court order, and can lead to practical issues).

In addition to any share security, the SPV would also grant a security package that would allow the financier to enforce certain rights against the asset and/or the SPV in order to protect its interest in the asset in the event of a default. The transaction documents would typically include covenants preventing the SPV from undertaking certain activities either in respect of itself or the asset without the consent of the financier, providing the financier with a further degree of control over the SPV.

4. Orphan SPV structures offer the benefit of Bankruptcy Remote Structuring

A key reason for establishing an off balance sheet SPV to hold an asset is to ensure that the structure is "bankruptcy remote". The primary purpose of a bankruptcy remote structure is to avoid any risk of the assets held by the SPV from becoming subject to bankruptcy proceedings in the event one of the transaction counterparties (for example, an airline lessee in respect of an aircraft, or a charterer in respect of a vessel) become subject to bankruptcy proceedings. Conversely, a bankruptcy remote structure would also protect the other transaction parties in the event that the SPV itself became subject to bankruptcy proceedings. In order to achieve this, the SPV will need to be structured in such a way that it is legally independent from both the originator/operator of the asset and the financier, and that none of the other transaction parties is able to exercise any direct control over the SPV. When properly structured, these are features that can be offered by a Cayman Islands orphan SPV structure.

In order to facilitate a bankruptcy remote structure, the transaction will need to be entered into on a "limited recourse" and "non-petition" basis. With a "limited recourse" SPV, the right of any transaction party to bring a claim against the SPV will be limited to the assets of the SPV. Broadly, this will be the underlying asset itself together with any earnings or proceeds of sale generated by that asset once all payments as required by the transaction documents have been made. Typically this will be achieved by including provisions in the transaction documents whereby the parties agree to contractually limit their recourse against the SPV (which is possible as a matter of Cayman Islands law and would be upheld by a Cayman Islands court). In addition to the limited recourse provisions, the transaction documents should also contain "non-petition" language, whereby the transaction parties agree not to petition for a liquidation or winding up of the SPV until following the termination of the financing transaction. This is to ensure that none of the parties contracting with the SPV can take any action to wind-up the SPV during the life of the transaction.

While the primary concern of a bankruptcy remote structure is to give financiers additional assurance that a bankruptcy event in respect of the owner/operator won't diminish the value or enforceability of their security, bankruptcy remote structures also give owners and operators some degree of comfort that the failure of a bank won't impact the asset, and that an even

in respect of asset itself won't negatively impact the operator/owner.

5. The Cayman Islands offer an ideal political, legal and fiscal environment for establishing an asset owning SPV

The Cayman Islands are recognised as a leading international financial centre, combining a well-established, stable and trusted legal and political framework with a flexible yet robust corporate regime, creditor-friendly laws and a tax neutral environment. These are all important considerations for both owners/operators and financiers when determining where to establish their asset-owning SPV.

As a British overseas territory, the legal system is based on English common law, and the Privy Counsel forms the ultimate court of appeal. The laws of the Cayman Islands are passed by a democratically elected legislative assembly and the electoral system is based on the British parliamentary model.

The Cayman Islands are a tax neutral jurisdiction, and no income, capital gains or withholding tax is imposed by the Cayman Islands government on any Cayman Islands SPVs or arises within the Cayman Islands as a result of any transactions entered into with a Cayman Islands SPV. Furthermore, a Cayman Islands SPV can apply to the Cayman Islands government for a tax exemption certificate confirming the SPV will not be subject to any such taxes in the Cayman Islands for a period of 20 years from the date of the certificate.

6. Cayman Islands SPVs offer a high degree of flexibility

The Cayman Islands corporate regime offers a great deal of flexibility, without burdening the SPV and its directors with excessive regulation. A Cayman Islands exempted company, which is the most popular corporate vehicle used for SPV transactions, offers the following benefits:

- Cayman Islands SPVs are generally incorporated with limited liability and have separate legal personality.
- A Cayman Islands SPV can have a single director, which need not be a natural person (i.e. corporate directors are possible).
- There are prima facie no nationality or residency requirements for directors or shareholders of a Cayman Islands exempted company.
- There is no minimum level of authorised or issued share capital for an SPV. A Cayman Islands exempted company has a great deal of flexibility in issuing, redeeming and repurchasing shares. In particular, the company may issue shares at a premium to their par value, and can use any proceeds of the share premium account arising from such issue to pay dividends.
- There are no statutory restrictions under Cayman Islands law preventing a company from providing financial assistance for the purchase of its own shares, and consequently no need for any whitewash procedure.
- Cayman Islands companies have separate legal personality.
- There is no requirement as a matter of Cayman Islands law for a Cayman Islands exempted company to appoint an auditor or file audited financial statements with the Registrar of Companies or any governmental body within the Cayman Islands.
- There are no exchange controls in the Cayman Islands

7. The incorporation requirements for Cayman Islands SPVs are quick and straightforward

Incorporating a Cayman Islands exempted company is a straightforward process. The Cayman Islands Registrar of Companies offers incorporation on an express basis, meaning that an SPV can be established within 1-2 business days.

In order to incorporate an SPV, the following documents will need to be filed with the registrar of companies:

- a signed copy of the memorandum and articles of association of the company;
- a declaration from the subscriber confirming that the activities of the company will primarily be conducted outside the Cayman Islands; and
- the appropriate filing fee.

The corporate services provider filing the incorporation will typically act as the initial subscriber to the memorandum and articles of association of a Cayman Islands SPV for the purpose of incorporation, following which the subscriber share will be transferred to the ultimate shareholder. There is no requirement for a director to be in place at the time of incorporation, although the registrar will need to be notified following their appointment.

The fees for incorporating and maintaining a Cayman Islands company are competitive and are calculated on a sliding scale based on the authorised share capital of the company.

8. The Cayman Islands have a pool of experienced independent SPV directors, Share Trustees and service providers with extensive knowledge of asset finance structures

The Cayman Islands have an established financial services industry. There are several large corporate service providers, experienced offshore attorneys and Class A banking institutions with detailed industry knowledge and experience of complex structured finance and asset finance transactions on hand to provide specialist services to asset finance SPVs.

In addition to providing independent SPV directors with extensive market-specific experience in the asset finance space, corporate service providers are also able to offer services such as FATCA and CRS reporting, AML services and accounting, audit and financial reporting functions.

9. Cayman Islands SPVs meet international regulatory and compliance standards

The Cayman Islands are a member of the Caribbean Financial Action Task Force (CFATF) and have implemented measures to comply with global FATF and OECD standards on anti-money laundering and anti-corruption. The Cayman Islands have consistently taken a proactive approach to ensuring they are in line with global standards on compliance and adhere to global tax transparency and reporting requirements under FATCA and the Common Reporting Standard (CRS). The Cayman Islands have also recently introduced legislation relating to beneficial ownership and economic substance to bring them in line with current global standards.

10. The Cayman Islands is a creditor friendly jurisdiction, making it ideal for establishing an SPV as part of a secured asset financing structure

As a creditor friendly jurisdiction, the Cayman Islands is attractive for financiers who are looking to establish an SPV as part of a secured asset financing structure. As a matter of Cayman Islands law, secured creditors will have the right to enforce their security in the event of a liquidation of the SPV in priority to unsecured creditors. Contractual subordination provisions are recognised, assuming they are effective under the governing law of the relevant agreement as a contractual matter, and non-petition provisions are statutorily recognised.

In addition, liquidators of Cayman Islands SPVs do not have the power to disclaim onerous contracts.

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