

## Article

## Rated Note Feeders and the Cayman Islands

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The ongoing convergence of the private equity and insurance sectors has recently led private equity managers to innovate in their investment structures offered to investors – and in particular to insurers. From a Cayman Islands perspective one of the most notable trends in this regard has been the emergence of ‘rated note feeders’ being established as Cayman Islands limited liability companies (LLCs) or exempted limited partnerships (ELPs). These rated note feeders bridge the accessibility gap between insurers and private equity funds and offer insurance companies an opportunity to diversify their investment portfolios with the stellar returns that private equity brings, while smoothing certain regulatory considerations that have in the past been a factor in considering such investments.

A knock-on effect of the emergence of these rated note feeders is that they are now also seen in the fund finance arena (where lenders make available facilities to private equity funds). In a standard fund finance (or ‘subscription finance’) deal the security that a bank takes against advancing the loan is primarily the right to call on the investors to fund their capital commitments and we have recently been called upon by a number of lender clients to advise on how these ‘rated note feeders’ fit into such a picture when compared with a ‘standard’ private equity investment vehicle – typically a Cayman Islands exempted limited partnership. We have set out below some commentary on the notable features and common queries surrounding Cayman Islands based rated note feeders.

### Rated Note Feeders

The features of a rated note feeder formed in the Cayman Islands commonly involve: (i) an LLC agreement or ELP LPA to form the vehicle; (ii) a note purchase agreement (NPA) pursuant to which the notes are constituted (and an associated offering memorandum for rating agency purposes in some instances); and (iii) a subscription agreement for notes (and in some cases a hybrid form allowing for part note and part ELP interest subscriptions). The overall goal and purpose of the documents is to make the investment more desirable to insurers while mimicking and re-creating to the extent possible the capital commitment and capital call mechanics of a standard private equity vehicle, except constituted in this case as a commitment to fund advances for the issuance of notes.

### Security Package in Fund Finance Deals

Outside of the various tweaks to the security documents to appropriately reference and capture the specific rights in question, the Cayman analysis for taking security over rights emanating from a Cayman law governed NPA is the same in all material respects to a grant of security over capital call rights contained in a Cayman law governed LPA. As a result of this, the assignment by way of security of such rights is typically captured in a New York law governed security agreement (for North American based deals).

As mentioned above, the Cayman classification of such security is materially similar to that of security over capital call rights and this rings true also for the question of how the secured party can perfect or gain priority of such security. For security over capital call rights a notice is commonly required by lenders to be sent to LPs post-closing to notify them of the security (which from a Cayman perspective obtains priority of the security interest for the secured party). The same analysis applies in the context of security over call rights contained in a Cayman law governed NPA and notice should be served on the noteholders post-closing in order to obtain priority of such security in the same fashion.

## Rated Note Feeders and Private Funds Act Registration Status

Most of the Cayman rated note feeders that we have encountered to date have been created with one investor in mind and so as a result end up being single investor vehicles and not a 'private fund' for the purposes of the PF Act. In other instances however we have seen note issuance feeders that have been a hybrid model of capital commitment and note commitments by multiple investors and in these circumstances the applicable vehicle has fallen within scope of the PF Act and accordingly the usual considerations (i.e. registration, appropriate covenants in the transaction documents, etc.) would apply. Rated note feeders are by their very nature bespoke and so careful analysis of the PF Act position is necessary in each case.

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