Cayman Islands –
Multi-Issuance Structures in the Cayman Islands

Introduction

This memorandum examines the options available to the capital markets practitioner seeking to set up a multi-issuance structure in the Cayman Islands. There are several different types of transactions that would call for a multi-issuance structure, the most common of which would be a bond or loan "repackaging" transaction. A "repackaging" generally describes an issue of notes by a company established specifically for that purpose (the "**Company**", "**Issuer**" or "**SPV**"), where the notes are secured on assets of the Issuer (the "**Underlying Assets**"). Such assets produce cash flows which can be used to generate the cash flows due on the notes, usually via a swap agreement with a Swap Counterparty. The Underlying Assets are said to have been "repackaged" into the notes issued by the Company. The purpose of a repackaging is to turn the Underlying Assets into an asset (the "**Notes**") with different features that better suit an investor's needs.

Contractual ring-fencing

Traditionally, these transactions have been carried out by putting in place "ring-fencing" provisions, to avoid the creditors of one series of Notes being able to have a legal claim on the assets of another series of Notes, and thereby ensuring that each series of Notes does not cross-collateralise another series of Notes issued by the Company. These ring-fencing provisions comprise two facets. Firstly, security will be granted over each separate pool of assets in favour of a security trustee, for the benefit of the holders of the particular series of Notes. Secondly, each contractual counterparty of the Issuer will enter into a "limited recourse" covenant with the Issuer, by which the counterparty acknowledges that it only has recourse to the assets of the particular series of Notes, and has no claim against any other assets of the Company. This approach has been current since the 1980s, and has the full blessing of the international rating agencies.

The segregated portfolio company

Cayman Islands companies law makes provision for Segregated Portfolio Companies ("**SPC**"). The purpose of the SPC is to statutorily allow the establishment of different "segregated portfolios" or "cells" within one single corporate entity. The effect is to statutorily enshrine the concept of ring-fencing, such that assets and liabilities of the Company would be attributable only to a particular segregated portfolio and, subject to certain exceptions, be available only to creditors of a particular portfolio.

Whilst the SPC constitutes one legal entity, each segregated portfolio is individually notified to the Registrar of Companies in the Cayman Islands. In addition to having segregated portfolio assets, the SPC may have general assets which can be used to fund its general corporate obligations, for example fees for the management of the SPC. Further, each cell can issue shares, and proceeds of issuance of segregated portfolio shares can have the benefit of the statutory ring-fencing.

When setting up each new cell, proper advice will be needed from Cayman Islands' legal counsel. While not required under the statute, good practice would suggest having a separate minute book for each of the cells. In relation to each contract that is entered into by a particular cell, great care must be taken to ensure that the contract refers to the particular segregated portfolio that is the contracting party: failure to do so would mean that the asset/liability would be a general asset/liability of the Company as a whole and the directors of the SPC may have personal liability for any resulting losses.

A comparison of the two approaches

The SPC has a strong advantage in that it encompasses statutory ring-fencing. Unlike debt, it is not possible to use the contractual ring-fencing mechanism in relation to preference shares, since shareholders' interests cannot be the subject of security. However, such ring-fencing for shareholders' interests could be achieved using an SPC. A potential weakness of the contractual approach relates to non-contractual creditors (such as, possibly, the IRS or the Inland Revenue) who would not have recourse limited to a specific pool of assets (even though the tax claim might have been brought about by a particular pool of assets). By using an SPC, third parties as well as consensual parties, are bound by the statutory ring-fencing.

A potential weakness of the SPC is that where the winding-up of an SPC takes place or its assets are otherwise dealt with by a court in a jurisdiction other than the Cayman Islands, it is possible that the statutory segregation could be overlooked, and that all assets or the Company would be viewed by the insolvency or other court as general assets of the Company. This risk could be dealt with by obtaining a legal opinion from legal counsel in the jurisdiction where the assets of the Company are located, and secondly by combining the two approaches of using the contractual ring-fencing in conjunction with the statutory ring-fencing.

Conclusion

In many instances, effective ring-fencing for a multi-issuance vehicle might be achieved by using a combination of the traditional contractual limited recourse arrangements, in conjunction with the SPC. In this way, the advantages of each approach as set out above can be combined, to provide investors in the product the best possible legal protection against cross-collateralisation in a multi-issuance structure.

February 2020

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