GUIDE

APPLEBY

GUIDE TO INVESTMENT FUNDS IN THE CAYMAN ISLANDS

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PREFACE

This Guide is a summary of the law and procedures relating to the establishment and operation of investment funds in the Cayman Islands.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have; it is not intended to be comprehensive. If any such questions arise in relation to the contents, they may be addressed to any member of the Appleby Fund Team, using the contact information provided at the end of this Guide.

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1. CAYMAN ISLANDS - JURISDICTION OF CHOICE

The Cayman Islands is a jurisdiction recognised worldwide as an international financial centre of the highest calibre. Leading financial institutions, Fortune 500 companies and private and public businesses from across the globe have chosen the Cayman Islands as their jurisdiction of choice for many reasons, including the following:

Reputation: due to its well established legal system, stability and strong financial services industry, the Cayman Islands have a reputation as a high quality offshore centre.

Flexibility: the Cayman Islands have the advantage of progressive "leading edge" legislation, developed in consultation and collaboration with industry stakeholders.

Central Time Location: the Cayman Islands' central time location (GMT-5) is ideal for organisations operating their businesses from Asia, Europe and the Americas.

Tax neutrality: the Cayman Islands has no capital gains, income, profits, corporation or withholding taxes (whether on the investment fund or its investors). If the investment fund is incorporated as an exempted company it can obtain a renewable undertaking from the Cayman Islands Government that it will remain tax-free for a 20 year period and in the case of exempted trust or an exempted limited partnership the period is up to 50 years. Investors in Cayman Islands vehicles must always obtain advice on the impact of taxation in the jurisdiction in which they are tax resident before investing.

Speed: once all necessary information, including 'know your client' documentation, is gathered and verified, all types of investment funds can be established and registered very quickly.

Availability of world-class professional services: the Cayman Islands has a wealth of lawyers, accountants, professional directors, administrators and other service providers with renowned expertise.

Trustworthy and reliable legal system: Cayman Islands law, derived from English common law and supplemented by local legislation, ensures that Cayman Islands entities are internationally understood and accepted. The Cayman Islands court system is well developed with appeals ultimately going to the Privy Council in London.

Compliance culture: the Cayman Islands has long been committed to implementing best international practices and is compliant with the anti-money laundering and anti-terrorist financing requirements of the Organisation of Economic Cooperation and Development (**OECD**) and Financial Action Task Force. The Cayman Islands is on the OECD "white list" and has entered into a multitude of tax information exchange agreements.

Stable and business-oriented government: the Cayman Islands are a British Overseas Territory and have a history of stable government, committed to promoting the financial services industry.

Sensible and Proportionate Regulation by the Cayman Islands Monetary Authority (**CIMA**): CIMA's mission is to regulate and supervise the financial services industry in order to maintain a first class financial system. CIMA's focus is on safeguarding the interests of investors in, and customers of, regulated institutions from undue loss. CIMA has regard to international standards and the need for operational freedom by financial services providers, with the focus on maintaining a dynamic and competitive industry.

Exchange Controls: there are no exchange control regulations in the Cayman Islands. As such, money and securities in any currency may be freely transferred to and from the Cayman Islands.

With this extensive portfolio of advantages, it is unsurprising that the Cayman Islands have established itself as a leading offshore banking and trust companies centre.

2. INVESTMENT FUNDS

2.1 What is a "Mutual Fund"

The primary legislation in the Cayman Islands relating to open-ended investment funds is the Mutual Funds Law. A "mutual fund" is defined as a common investment vehicle which issues "equity interests" that allows participation amongst a pool of investors in the profits or gains of such vehicle's investments. These investment vehicles can be structured as companies, unit trusts or limited partnerships.

An "equity interest" means a share in a company, a unit in a unit trust or an interest in a partnership that carries an entitlement to participate in profits or gains and which is redeemable or redeemable at the option of the investor. Accordingly, closed-end investment vehicles, whose equity interests are not redeemable at the option of the investor, are not required to comply with the Mutual Funds Law.

2.2 Different Categories of Mutual Funds

There are four types of mutual funds:

- exempt mutual funds;
- registered mutual funds;
- administered mutual funds;
- licensed mutual funds.

In general terms, a mutual fund will be carrying on business in or from the Cayman Islands if:

- it is incorporated or established in the Cayman Islands; or
- it is managed or administered in the Cayman Islands, regardless of its place of incorporation or establishment.

Exempt Mutual Funds

Funds need not comply with the Mutual Funds Law if:

- the equity interests are held by not more than 15 investors; and
- the majority, in number, of them are capable of appointing or removing the operator of the mutual fund (i.e. the directors of a company, the trustee of a unit trust or the general partner of a partnership).

Registered Mutual Funds

Registered funds are the most common form of mutual funds in the Cayman Islands. For a registered mutual fund, the initial minimum subscription per investor must be at least US$100,000 (or equivalent).

A registered mutual fund is not required to be licensed. Instead, it is only required to register its offering memorandum and certain prescribed details relating to the offering of its equity interests with CIMA.

Fees are payable to CIMA on registration and annually thereafter.

All registered mutual funds must have their audited financial statements prepared or signed off by an approved Cayman Islands auditor and filed with CIMA within six months of their financial year end.

Administered Mutual Funds

A mutual fund will be an administered mutual fund if its principal office in the Cayman Islands is provided by a licensed mutual fund administrator and there is no minimum initial investment amount. The registration process for an administered mutual fund is the same as that for a registered mutual fund, except that it must file an additional form which is signed by the Cayman Islands licenced mutual fund administrator with CIMA.

Licensed Mutual Funds (also known as "retail funds")

Licensed mutual funds are the rarest form of mutual funds regulated under the Mutual Funds Law.

Unless a mutual fund falls within one of the other categories described above, it must obtain a mutual fund licence.

All licensed mutual funds must have a registered office in the Cayman Islands or, in the case of a unit trust, have a locally licensed trustee.

An exempt mutual fund, a registered mutual fund or an administered mutual fund can voluntarily choose to be licensed.

Master Funds

Any Cayman Islands company, unit trust or partnership which issues equity interests and has a feeder fund which is regulated by CIMA investing in it must register as a master fund. The registration requirements are less stringent and unless the master fund itself has an offering document already, it need not have one for registration.

3. INVESTMENT FUND STRUCTURES

Cayman Islands investment funds are established utilising a range of fund vehicles and structures depending on the needs of fund promoters and proposed investors. When deciding on what type of vehicle and structure to use, tax considerations typically factor into the analysis. Cultural factors are also often taken into account, as it is usually desirable to choose a vehicle or structure with which potential investors are already familiar and therefore comfortable investing in.

Typical structures include:

Stand-alone: the simplest structure is a stand-alone investment fund vehicle. Under this structure investors simply purchase equity interests in a single vehicle.

Multi-class or Umbrella: multi-class funds have shares or units split into a number of different classes, each with different investment objectives and pools of underlying investments. Such funds are often established as segregated portfolio companies (see below).

Side-by-side: side-by-side fund structures usually involve the establishment of a stand-alone on-shore fund and a stand-alone Cayman Islands fund. Under this structure the on-shore and the Cayman Islands fund will each individually make identical investments in assets managed by the same investment manager.

Master/Feeder: master/feeder structures typically involve three investment fund vehicles: an onshore feeder fund, an offshore (Cayman Islands) feeder fund and an offshore (Cayman Islands) master fund. Under this structure the onshore and offshore feeder funds invest in the master fund, which utilises the proceeds of such investments to acquire a pool of assets. Usually such structures are established to allow US investors to invest in the offshore master fund via the onshore feeder fund and for US tax exempt investors and non-US investors to invest in the offshore feeder fund. In some cases only two investment fund vehicles are used, in which case US investors will invest in the onshore feeder and US tax exempt and non-US investors will invest directly into the offshore master fund.

Master funds, both newly created and those already existing in a traditional master/feeder structure are required to register with CIMA. Those existing as closed-ended funds and master funds that do not have Cayman Islands regulated feeder funds investing in them are not subject to the same registration requirements.

Fund-of-Funds: this is more descriptive of investment objectives rather than structure. A fund-of-funds has the investment objective of investing its investment capital in other investment funds.

4. INVESTMENT FUND VEHICLES

4.1 Exempted Companies

Exempted companies are established under the Companies Law (as revised), and are the most common form of entity used for the establishment of investment funds.

The authorised share capital of an exempted company is generally divided into shares of a fixed par value amount which may be expressed in foreign currencies. The registration fee and the annual return fee are computed on the basis of the company's authorised share capital.

There are only a few requirements for exempted companies to satisfy. An exempted company must have a registered office in the Cayman Islands; have at least one shareholder of record; details of directors and officers must be furnished to the Registrar of Companies but these are not publicly available and each year a return must be filed which confirms that the company has conducted its business activities outside the Cayman Islands.

Although CIMA requires there to be at least two directors or a corporate director with at least two directors for a registered, licensed or administered mutual fund, there is no requirement for the directors of an exempted company to meet in the Cayman Islands and there are no restrictions on the nationality or place of residence of the directors or shareholders of such companies.

4.2 Segregated Portfolio Companies

Exempted companies may register as segregated portfolio companies (**SPC**). An SPC is akin to a segregated cell company in many other jurisdictions.

An SPC may establish any number of segregated portfolios, which are internal accounts to which assets and liabilities may be attributed. Assets and liabilities attributed to a particular portfolio are legally separated from the assets and liabilities of the company's ordinary account (called its "general assets") and also from those attributed to any other segregated portfolio. A creditor who is party to a contract involving a particular portfolio will have restricted recourse and will be entitled to make its recovery only as against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed. No claim can be made against the general assets or the assets attributed to other portfolios (save to the extent otherwise provided in any relevant contract).

SPCs are useful as multi-strategy vehicles and platform vehicles.

For more information on these types of companies, please see our Guide to Segregated Portfolio Companies.

4.3 Unit Trusts

Cayman Islands unit trusts are established under and governed by the Trusts Law (as revised) and English equitable principles. Each unit trust will be constituted under a trust deed that provides the terms on which the trustee holds the trust's assets for unit holders.

Provided the trust deed is properly drafted and the trust property of each separate trust established under the trust deed is properly managed, multi-class unit trusts provide an effective method of establishing multi-class funds without cross-class liability issues arising.

Exempted Unit Trusts: most unit trusts are registered as exempted trusts. Exempted trusts, like exempted companies, are entitled to a renewable tax undertaking from the Cayman Islands Government. Such tax undertaking provides that for 50 years the trust will not be subject to any laws imposing any tax or duty on income or on capital assets, gains or appreciation or any tax in the nature of estate duty or inheritance tax with respect to any property comprised in or income arising under the trust or to the trustees or the beneficiaries of the trust.

4.4 Exempted Limited Partnerships

An exempted limited partnership (**ELP**) is a limited partnership registered under the Exempted Limited Partnership Law (as revised) (**ELP Law**).

An ELP must maintain a registered office in the Islands and must have at least one general partner. At least one general partner must be resident in the Cayman Islands (either an individual, company or another ELP).

Limited partners must not take part in the conduct of the partnership business with third parties. However, a number of specific activities, similar to those appearing in US limited partnership laws, are deemed not to offend this principle.

As with exempted trusts, an exempted limited partnership can obtain a renewable 50 year tax undertaking.

The general partner must make an annual return to the Registrar regarding compliance with the Exempted Limited Partnership Law.

5. DIRECTOR REGISTRATION AND LICENSING

The Directors Registration and Licensing Law, 2014 imposes registration obligations on directors of registered mutual funds and certain securities investment businesses (**Covered Entities**). The registration fee is US$854 per director. Licences are required for "Professional Directors", being natural persons appointed to the boards of 20 or more Covered Entities and corporate directors of Covered Entities. Licence fees for Professional and Corporate directors are US$3,660 and US$9,756, respectively.

6. INVESTMENT MANAGERS

There is no restriction on the location of the investment manager of a mutual fund and many managers decide to set up a Cayman Islands vehicle as the investment manager or adviser to the mutual fund.

The Securities Investment Business Law (as revised) (**SIBL**) regulates the advisory and management services of investment managers and investment advisers incorporated, registered or with a place of business in the Cayman Islands.

Unless an investment manager or adviser falls within one of the exemptions provided by the legislation a securities investment business licence will be required and licensees must comply with statutory obligations.

The most common exemption for investment managers and advisers is where such activities are carried on exclusively for one or more of the following classes of person:

- Sophisticated Persons;
- High Net Worth Persons; or
- companies, partnerships or trusts of which the shareholders, unit holders or limited partners are Sophisticated Persons or High Net Worth Persons.

Investment managers and advisers established or carrying on business in the Cayman Islands appointed by Cayman Islands funds should be able to qualify for the above exemption from licensing because a mutual fund that is registered or licensed in the Cayman Islands under the Mutual Funds Law is considered a Sophisticated Person. Other exemptions from the requirement for licensing under SIBL may also apply if the fund is not so registered or licensed.

Investment managers and advisers who are exempt from the requirement to be licensed under SIBL must, however, file an annual declaration with CIMA to confirm their exempt status and pay the prescribed exemption fee.

For more information see our separate guide on SIBL.

7. SUPERVISION AND ENFORCEMENT

CIMA can require a special audit of a regulated mutual fund or licensee and each operator of a regulated mutual fund must ensure that such special audit is carried out. Each promoter or operator of a regulated mutual fund or licensee must give CIMA such information and access to such records as CIMA requires.

CIMA may apply to court to preserve the assets of a regulated mutual fund.

CIMA has power in relation to a regulated mutual fund or a licensee to revoke the relevant licence, impose conditions on the licensee, require the substitution of a promoter or operator, appoint advisers or persons to assume control of the affairs of the mutual fund or the licensee or require the reorganisation or winding up of the mutual fund or the licensee.

The auditor of a regulated mutual fund or licensee must immediately give written notice to CIMA if the licensee or mutual fund is, or is likely to become, unable to meet its obligations as they fall due, is carrying on or attempting to carry on business in a manner prejudicial to investors or creditors or is maintaining insufficient accounting records to allow its accounts to be properly audited.

Neither the Cayman Islands Government nor CIMA is liable for actions taken in relation to the Mutual Funds Law, except in the case of bad faith.

8. THE CAYMAN ISLANDS STOCK EXCHANGE

All Cayman Islands mutual funds may list their equity interests on the Cayman Islands Stock Exchange (**CSX**).

The CSX has been admitted to membership of the European Securitisation Forum (an independent initiative of The Bond Market Association) and has entered into a working relationship with Euroclear which allows CSX participants access to the Fundsettle system for enhanced transparency and communication with investors. The CSX is also an affiliate of the International Organisation of Securities Commissions (**IOSCO**).

Appleby (Cayman) Ltd. is a listing agent for the CSX and has significant experience in the listing of investment funds on this exchange and numerous other global exchanges. We would also be happy to provide introductions to selected administrators, accountancy firms and other professional director service providers.

For more specific advice on investment funds in the Cayman Islands, we invite you to contact:

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For the convenience of clients in other time zones, a list of contacts available in each of our jurisdictions may be found here.