

# GUIDE TO SEGREGATED PORTFOLIO COMPANIES IN THE CAYMAN ISLANDS

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## **PREFACE**

This Guide is a summary of the law and procedures relating to segregated portfolio companies in the Cayman Islands.

We recognise that this Guide will not completely answer detailed questions which clients and their advisers may have. If any questions arise, they may be addressed to any member of the team, using the [contact information](#) provided at the end of this Guide.

### **Appleby**

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## 1. **SEGREGATED PORTFOLIO COMPANIES**

A Cayman Islands company may be registered as a segregated portfolio company (**SPC**) under the Companies Law (the **Law**). The SPC is a single legal entity which may establish internal portfolios. Each portfolio's assets and liabilities are legally separated from the assets and liabilities of the company's ordinary account (called its "general assets") and are also separate from assets and liabilities attributed to the SPC's other segregated portfolios (if any).

A creditor entering into contractual dealings with a particular segregated account will have restricted recourse; it will only be entitled to make its recovery against assets attributed and credited to the specific segregated portfolio to which the contract is also attributed. The creditor will not be legally entitled to make recovery against assets attributed and credited to other segregated portfolios of the SPC, or (save to the extent otherwise provided in any relevant contract) against the general assets of the company.

The value of an SPC structure is immediately apparent: the SPC may be used in many circumstances where previously a group structure of various companies would have been required.

## 2. **APPLICATIONS**

### 2.1 **Advantages of the SPC Concept**

The SPC has several advantages over traditional routes to creating legal divisions between groups of assets and liabilities. It is less expensive and more efficient than forming numerous subsidiary companies. It avoids the need for explicit limited recourse provisions in contracts with third parties and the issues associated with such provisions (though such provisions may be retained as an added reinforcement). It also avoids issues of time, solvency and perfection in relation to charges that may be taken in conjunction with contractual limited recourse provisions.

The provisions of the Law governing the application of particular assets in favour of particular portfolios and their respective liabilities are substantive and it is believed that this will significantly enhance the prospects for enforceability of transactions in jurisdictions where the assets of a particular segregated portfolio might be situated.

### 2.2 **Range of Applications**

The Law represents a major opportunity for many international businesses. Prospective uses include insurance companies, "master-feeder", umbrella or other mutual fund structures providing for multiple classes of shares and multiple investment options, property development companies, e-commerce companies, ship and aircraft (or fleet) owning companies, non-insurance securitisation and derivatives transactions, replacement for operating subsidiaries or divisions of any company, facilitation of product line or geographic segmentation, temporal segregation and a variety of trust company arrangements. The list could easily go on and is bounded only by the imagination and creativity of clients and their professional advisors. Some of these potential applications are considered in more detail below.

#### **Mutual Funds**

In the field of investment funds, traditionally the need to have efficient structures whereby investors could access different trading strategies or other differential features through a single vehicle led to the development of "multi class" and "umbrella" funds. In the case of a corporate multi-class fund there is typically a single entity offering various classes of shares designated according to, say, the intended

investment strategy with “pools” or portfolios of assets, relating to that strategy expressed to be attributable to a relevant particular share class.

In the event of the winding up of a multi-class fund, however, the segregation breaks down with distributions being made in the liquidation to creditors generally and there is also the possibility of a creditor attaching an asset without regard to its attribution to a particular class in the fund. Properly organised corporate umbrella funds involving a feeder fund with subsidiary trading entities address this problem of “cross-class” liability and achieve the desired segregation of assets but with the cost and complication of a group structure.

The SPC provides an attractive alternative and gives the SPC, through a single legal entity, the ability to operate in a way analogous to a corporate group comprising parent and subsidiaries.

### **Capital Markets and Securitisation Transactions**

In capital markets and securitisation transactions, the ability to limit recourse of a creditor holding a particular class or series of the issuer company’s debt securities to specific underlying assets in an efficient way, through use of segregated portfolios, is attractive.

### **Companies Owning Real Estate, Ships, Aircraft or Other Assets**

Traditionally, certain businesses holding multiple assets (e.g. real estate, ships or aircraft companies) are structured such that within the group a separate subsidiary company is used to hold individual (or groups of individual) underlying assets. An SPC, however, may provide a more efficient and cost effective alternative where each asset is owned by a separate segregated portfolio.

### **Business Divisions**

Similar considerations may apply where a business is operated on the basis of several discrete divisions within a single company or group.

In certain cases an SPC may be a convenient and effective structure for joint venture arrangements, for example, where a particular party to the venture is to retain effective indirect ownership of a given asset or income stream within the joint venture structure.

### **Ring-fencing in Special Cases**

There are potential applications for SPCs in the context of corporate rehabilitation and reorganisation. For example, where multiple parties participate in a rescue of a business in financial difficulty, it may be appropriate for them to do so with the benefit of liability segregation which can be efficiently achieved through an SPC.

### **Trust Applications**

Employee benefit schemes and other arrangements, where a trust might otherwise be used, lend themselves to the idea of an SPC structure.

Where a trustee operates numerous trusts for unrelated beneficiaries, the assets and liabilities of each trust are already legally separated. Nevertheless, at least for administrative purposes, it may be appropriate to reinforce the division between the assets and liabilities of each trust, and between those and the trustee’s own assets and liabilities, by using an SPC as the trustee. Special licensing as a trustee company may be required in addition to registration as an SPC.

## Insurance

SPCs may be used for a variety of insurance purposes including rent-a-captives, life and annuity companies, transformer vehicles, as well as financial guarantee, securitisation and derivatives structures, and special purpose vehicles.

### 3. REGISTRATION UNDER THE LAW

#### 3.1 Application Procedure

Pursuant to the Law, any exempted company (including one already incorporated) may apply to the Registrar of Companies (the **Registrar**) to be registered as an exempted segregated portfolio company. If the company is already regulated by the Cayman Islands Monetary Authority (**CIMA**), then the Registrar will only register a company as an SPC if it has first received written consent from CIMA. CIMA's prior written consent to the registration as an SPC is required in the case an existing mutual fund which is regulated under the Mutual Funds Law. CIMA's written consent is not required, however, in order to register new entities as SPCs.

Where the applicant company is already in existence (i.e. the application to register as an SPC is made other than on the initial incorporation of the exempted company), the company must pay a nominal fee and file with the Registrar an accurate declaration made by at least two directors of the company setting out the following:

- the assets and liabilities of the company at a date within three months prior to the date of the application;
- any transaction or event which has occurred (or is expected to occur) between the date of the statement of assets and liabilities and the date of registration of the company as an SPC which, if it had occurred before the date of the declaration, would have caused material changes to the assets and liabilities disclosed in that statement;
- the segregated portfolios which the company intends to operate, and the assets and liabilities which the company proposes to transfer to each of those segregated portfolios;
- that, on registration as an SPC, the company and each segregated portfolio will be solvent; and
- that each creditor of the company has consented in writing to the transfer of assets and liabilities into segregated portfolios or adequate notice (in writing) has been sent to every creditor having a claim against the company exceeding US\$1,219.51 and 95% by value of those creditors' consent.

In addition, the company must pass a special resolution authorising the transfer of assets and liabilities into separate portfolios (and attach a copy of such a resolution to the above declaration). As mentioned above, if the existing company is regulated by CIMA, the consent should also be attached.

Any initial transfer of assets and liabilities into segregated portfolios will not be subject to the Fraudulent Dispositions Law (revised).

There are criminal sanctions for a false declaration: a director who makes a declaration without reasonable grounds or who knowingly makes a false declaration will be liable on summary conviction to a fine or imprisonment of one year.

### 3.2 Registration

In addition to the usual fee payable on registration as an exempted company, a small fee is payable for registration as an SPC. Please enquire for current fees.

An SPC must include in its name the letters "SPC" or the words "Segregated Portfolio Company".

### 3.3 Annual Requirements

In addition to the annual fee that is payable for an exempted company in January of each year, an SPC must also pay an additional fee to maintain its registration as an SPC and a nominal fee for each portfolio (this being capped). Please enquire for current fees.

At the same time as it tenders the fees referred to above, an SPC is required to furnish to the Registrar a notice containing the names of each segregated portfolio it has created.

## 4. THE NATURE OF SEGREGATED PORTFOLIOS

An SPC may create one or more segregated portfolios for the purpose of segregating the assets and liabilities of the company held within or on behalf of a segregated portfolio from the assets and liabilities of the company or not held within or on behalf of any segregated portfolio. Each segregated portfolio must be separately identifiable and such identification must include the words "Segregated Portfolio", "SP" or "S.P".

The Law confirms that an SPC is a single legal entity and that a segregated portfolio does not constitute a legal entity separate from the company.

## 5. MANAGEMENT AND ADMINISTRATION

### 5.1 Local Representatives

All exempted companies, including SPCs, must have a registered office in the Cayman Islands. No additional requirements apply by virtue only of the fact that the company is an SPC. If, however, other regulatory laws apply (i.e. if the company is an insurance company or a registered fund), there may be additional requirements.

### 5.2 Management Duties

The Law sets out a number of duties that the SPC and the SPC's directors each have to fulfil. Some key duties are outlined below.

#### Segregation of Assets

In addition to their duties to the company that are imposed by statute and the common law by virtue of their position as directors, the directors of an SPC are also under a statutory duty to establish and maintain (or cause to be established and maintained) procedures to keep segregated portfolio assets segregated and identifiable from both the general assets of the SPC and the assets of other segregated portfolios, and to ensure that assets and liabilities are not transferred between segregated portfolios otherwise than at full value.

#### Contracts with Third Parties

The Law provides that any act, matter, deed, agreement, contract, instrument under seal or other instrument or arrangement which is to be binding on a segregated portfolio must be executed by or on

behalf of the directors and on behalf of the relevant segregated portfolio. In addition, any such document must indicate that its execution is in the name of, or by, or on account for the relevant segregated portfolio.

Notwithstanding any provision to the contrary in the articles or in any contract or otherwise, if an SPC is in breach of the above, the directors shall upon becoming aware of such breach (a) make enquiries to determine the correct segregated portfolio to which the relevant act, matter, deed, agreement, contract, instrument under seal or other instrument or arrangement should be attributed; (b) make the correct attribution, and (c) notify in writing all persons which are party to the act, matter, deed, agreement, contract, instrument under seal or other instrument or arrangement that was executed, or which may be adversely affected by any such attribution, of that attribution and the parties' rights.

Any person notified who objects to an attribution by the directors may apply to the Court within thirty days by petition for a reattribution. The Court may make such ancillary orders, based on the facts and the parties' intentions, as are just and equitable in the case.

Any indemnity given by an SPC in favour of a director in respect of a liability incurred by such a director on behalf of a segregated portfolio will only be enforceable against the assets of the segregated portfolio in respect of which such liability arose.

### **Accounts, Records and Registers**

As noted under the heading "Segregation of Assets" above, the SPC must segregate portfolio assets. This will have an impact on record keeping and it is implicit in the Law that some accounting records must be maintained for each segregated portfolio. However, generally the rules that apply to an SPC in relation to its accounts, records and registers are the same as those that apply to an ordinary Cayman exempted company. For more information, please refer to the "Guide to Companies in the Cayman Islands" which is available from the Appleby website.

### **Effect of Infringement of the Law**

The legislation does not state that a transaction or interest in a segregated portfolio becomes ineffective by reason only that the SPC fails to comply with, or is in breach of, any provision of the Law. Accordingly, and subject to the usual rules of capacity, power and constructive notice, a transaction or interest in a segregated portfolio will generally be effective notwithstanding the fact that the company may be in breach of particular requirements of the provisions of the Law with respect to SPCs.

## **6. GOVERNING INSTRUMENTS AND CONTRACTS**

As noted above under the heading "Contracts with Third Parties", SPCs are subject to particular rules in relation to the execution of contracts. Apart from this, the rules in the Law that apply to companies generally in relation to contracts apply equally to SPCs. For example, any contract which, if made between private persons would be required by law to be in writing and signed by the parties to be charged therewith, may be made on behalf of the company in writing and signed by any person acting under the express or implied authority of the company.

There are no explicit provisions in the Law with respect to the ability of portfolios to contract with each other or the general portfolio. However, and on general principles, it is doubtful that an SPC acting on behalf of one segregated portfolio could contract with itself on behalf of another segregated portfolio. That said, the Law expressly recognises the transfer of assets and liabilities between segregated portfolios provided these are at full value.

## 7. ASSETS AND LIABILITIES

### 7.1 Application of Assets and Liabilities

The Law provides that an asset of an SPC must be either a “segregated portfolio asset” or a “general asset”.

Segregated portfolio assets comprise assets representing the share capital and “reserves” attributable to the segregated portfolio, as well as all other assets attributable to or held within the segregated portfolio. “Reserves” includes profits, retained earnings, capital reserves and share premiums.

Accordingly, the general assets of the SPC comprise the assets of the company which are not segregated portfolio assets. For example, this may be income, receipts and other assets or rights acquired by the SPC that are not otherwise attributable to any segregated portfolio.

Segregated portfolio assets will only be available and used to meet liabilities to the creditors of the SPC who are creditors in respect of that segregated portfolio and who will therefore be entitled to have recourse to the segregated portfolio assets attributable to that segregated portfolio for such purposes.

Segregated portfolio assets are therefore not available to meet liabilities, and shall be absolutely protected from, the creditors of the SPC who are not creditors in respect of that segregated portfolio.

For these reasons, where a liability of an SPC to a person arises from a matter, or is otherwise imposed, in respect of a particular segregated portfolio, such liability will only extend, and that person shall primarily only have recourse, to the assets of the segregated portfolio in question. However, the Law also provides that, unless specifically prohibited by the company’s articles of association, where the segregated portfolio’s assets are insufficient to satisfy a liability, and to the extent that the assets attributable to such SPC’s general assets exceed any minimum capital requirements imposed by a Cayman regulatory body, then the creditor of a particular portfolio may also have access to the SPC’s general assets. In no circumstances, however, will such creditor be entitled to have recourse to the assets of any other segregated portfolio. Accordingly, where a liability of an SPC to a person arises or is imposed otherwise than in respect of a particular segregated portfolio, then that person shall only have recourse to the SPC’s general assets in respect of that liability.

Nothing in the Law prevents the directors of an SPC from permitting both segregated portfolio assets and general assets to be held by or through a nominee of the company.

### 7.2 Rights of a Shareholder

As noted above, the rights of a shareholder whose shares relate to a specific segregated portfolio will be set out in the articles of association or terms of issue of such shares (including, where applicable, a prospectus or offering document). The Law does not provide any additional requirements in this respect by virtue of the company being registered as an SPC.

### 7.3 Creditor Enforcement Rights over Portfolio Assets

Should a creditor in respect of a particular segregated portfolio enforce his claims against assets not attributable to the segregated portfolio to which he is a creditor then, although the matter is not explicitly covered in the Law, and following general principles, the SPC and potentially the creditors of the segregated portfolio which is now deficient may seek an equitable remedy.

#### 7.4 **Cross-Jurisdictional Recognition**

An SPC may operate or have assets, or be subject to claims, in jurisdictions that may not recognise the segregation of assets and liabilities. In those jurisdictions, the assets of one segregated portfolio may potentially be exposed to the liabilities of another. This risk is higher in jurisdictions that do not have segregated portfolio type legislation. Currently there is very little, if any, case law in such jurisdictions in which the structure and standing of a Cayman SPC have been tested. Accordingly there is very little guidance to indicate the manner in which the courts will deal with this issue. The Cayman Islands legislation with respect to SPCs is substantive as opposed to procedural and this should mitigate the non-recognition risk on the basis that a foreign court, in applying the law of another jurisdiction, more usually respects substantive provisions even though it may apply its own procedure.

The risk is likely to be reduced if the SPC holds its assets in jurisdictions that have segregated accounts legislation, for example the Cayman Islands, Bermuda, the British Virgin Islands, Guernsey, Jersey and Mauritius, and if relevant contracts are governed by the law, and made subject to the jurisdiction of the courts of a segregating jurisdiction, such as the Cayman Islands. Further protection is gained if contracts contain language that limits the recourse of any potential creditor of a particular segregated portfolio to the assets in the relevant segregated portfolio.

In considering these issues, it is likely that a court (even in a jurisdiction with equivalent legislation) considering a Cayman SPC would also have close regard to whether the SPC has in fact been operated in accordance with the requirements of the Law. For this reason (among others), it is important that these requirements are strictly adhered to.

### 8. **SECURITIES**

#### 8.1 **Issue of Securities by a Segregated Account**

The Law expressly provides that an SPC may issue shares in respect of a segregated portfolio; they may be issued in classes or series and their proceeds are included in the assets of the corresponding segregated portfolio. The proceeds of the issue of shares other than segregated portfolio shares must be included in the SPC's general assets.

#### 8.2 **Dividends, Distributions and Redemptions**

An SPC may pay a dividend or make a distribution in respect of shares of any class attributed to a segregated portfolio irrespective of whether a distribution is declared on any other class of shares attributed to that portfolio, or any shares.

Dividends or distributions may only be paid on segregated portfolio shares by reference to the accounts of the segregated portfolio and from its assets, in accordance with the rights of such shares.

There are no explicit requirements in the Law with respect to share redemptions that apply to a company by virtue of the fact that it is an SPC. However, it follows from the segregation requirements (see above) that redemption proceeds should be paid from the applicable segregated portfolio. For more information on this topic, please refer to our "Guide to Companies in the Cayman Islands", which is available from the Appleby website.

#### 8.3 **Reduction of Capital/Capital Transactions**

There are no explicit requirements in the Law that apply to a company by virtue of the fact that it is an SPC in respect of a reduction of capital transaction, although the segregation requirements of the Law

will impact on such a transaction in practice. For more information on this topic, please refer to our “Guide to Companies in the Cayman Islands”, which is available from the Appleby website.

## 9. **WINDING UP**

### 9.1 **Winding Up of an SPC**

The general provisions of the Law as to winding up apply equally to SPCs, but, notwithstanding any statutory provision or rule of law to the contrary, in the liquidation of an SPC the liquidator is under a duty to deal with both the general assets and segregated portfolio assets in the same fashion that a director is under a duty to deal with the general assets and the segregated portfolio assets. Accordingly, in the discharge of the claims of creditors of the SPC, the liquidator must apply the company’s assets to those entitled to have recourse thereto in conformity with the Law. In other words, the assets and liabilities that are attributed to each segregated portfolio may only be available and be used to meet liabilities owed to the creditors of the SPC who are creditors of that segregated portfolio, and shall not be available or be used to meet liabilities owed to, and shall absolutely be protected from, the creditors of the SPC who are not creditors in respect of that segregated portfolio.

### 9.2 **Termination and Reinstatement**

Where a segregated portfolio has no segregated portfolio assets or liabilities of the SPC attributable to it, the SPC’s directors may resolve (subject to the provisions of its articles of association) to terminate such segregated portfolio.

The directors may also resolve to reinstate a segregated portfolio which has been terminated.

### 9.3 **Removal from the Register**

The general rules in the Law with respect to removal of defunct companies from the Register apply equally to SPCs.

## 10. **CONCLUSION**

The legislation pertaining to SPCs represents a major opportunity for many international businesses, particularly in the mutual fund and insurance industries, to exploit a structure allowing for cost effective and efficient segregation of assets and liabilities within a single legal entity.

For more specific advice on segregated portfolio companies 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](#).

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