

CAYMAN ISLANDS FUNDS

CHRIS HUMPHRIES, MANAGING DIRECTOR AT STUARTS WALKER HERSANT HUMPHRIES, DISCUSSES WHAT THE CAYMAN ISLANDS HAS TO OFFER PROSPECTIVE HEDGE FUNDS



Chris Humphries

is the managing director and one of the founding directors of Stuarts. He is a recognised leader in his field by Chambers & Partners and Legal 500; he has registered several hundred mutual funds with the Cayman Islands Monetary Authority and frequently advises on regulatory and compliance issues involving funds, investment managers and fund administrators.

As the principle offshore jurisdiction for hedge funds and mutual funds, the Cayman Islands has sought to retain its status by implementing an innovative legislative and regulatory regime and by continuing to have an absence of taxation. Given the historic success of the Cayman Islands as a fund domicile, it also boasts the presence of sophisticated and professional service providers who are well-versed in the nuances of the fund industry.

Some of the core benefits to a fund being domiciled in the Cayman Islands are:

1. A quick and efficient regime for the registration of funds.
2. An effective and comprehensive regulatory environment which is both robust enough to give investors' confidence yet flexible enough to be appropriate for different types/sizes of funds.
3. Legal, administrative and accounting service providers with a wealth of experience in the fund industry are readily available.
4. All of a fund's directors or officers, managers, administrators or custodians are required to be situated in the Cayman Islands.
5. A fund's investment objectives, trading strategies, leverage or trading limits are its own to manage and the Cayman Islands government does not seek to impose restrictions on commercial matters.

The principal legislation concerning the regulation of investment funds in the Cayman Islands is the Mutual Funds Law (2013 Revision). The Mutual Funds Law creates four types of mutual funds that are subject to regulation and supervision under the Mutual Funds Law by the Cayman Islands Monetary Authority (CIMA):

1. **Registered mutual funds** - A simplified registration procedure is available for mutual funds in circumstances where:
 - (i) The initial minimum equity interest purchasable by an investor is US\$100,000; or
 - (ii) Equity interests are listed on an approved stock exchange such as the CSX.

In order to register, the appropriate forms must be filed with CIMA together with a copy of the current offering document, consent letters from the auditors and the administrators and payment of the applicable registration fee.

Where the fund is not a registered mutual fund and is not otherwise excluded from regulation, it must either apply to CIMA for a mutual fund licence or apply to be regulated as an administered mutual fund.

2. **Licensed mutual funds** – A mutual funds licence is suitable for retail funds with a large and reputable promoter who does not intend to appoint a Cayman Islands administrator. In order to obtain a mutual fund licence, the fund is required to:

- (i) File and maintain on file with CIMA a current copy of the fund's offering document;
- (ii) Maintain a registered office in the Cayman Islands (or if a trust, a licensed trust company acting as trustee);
- (iii) Appoint a reputable administrator which may or may not be an administrator based in the Cayman Islands; and
- (iv) Provide such information to CIMA as is necessary to evidence the soundness of the promoter, the expertise of the administrator and that the directors are fit and proper persons.

3. **Administered mutual funds** - To be regulated as an administered mutual fund, the fund must appoint a Cayman Islands licensed mutual fund administrator to provide its principal office in the Cayman Islands. Although a majority of the supervisory functions which are performed by CIMA for licensed mutual funds (such as verifying the reputation and suitability of the promoter and the administrator and ensuring compliance with the Mutual Funds Law) is carried out by the Cayman Islands administrator, CIMA maintains a general supervisory and enforcement role with respect to administered mutual funds.

4. **Non-Cayman Islands funds** – Funds that are established or incorporated outside of the Cayman Islands



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but whose management or administration is provided in the Cayman Islands may be required to be registered with CIMA in the Cayman Islands. If a corporate mutual fund is subject to regulation under the Mutual Funds Law it must first register as a foreign company under the Companies Law (as Revised) to be licensed or registered as a mutual fund.

In addition, the Mutual Funds Law provides a number of exceptions where funds are not subject to any specific regulation in the Cayman Islands. These include:

- Funds with only one investor (as there is no pooling of investor funds);
- Funds issuing debt rather than an equity interest;
- Closed-ended funds or private equity vehicles which do not permit redemption or repurchase of interests at the option of the investor; and
- Investment funds with no more than 15 investors, the majority of whom have the power to appoint or remove the operators of the investment fund (i.e. the directors, the general partner or the trustee, as the case may be) other than Cayman Islands regulated master funds.

There are more than 10,000 registered funds and master funds in the Cayman Islands. These regulated funds are generally designed for more sophisticated investors such as those investing US\$100,000 or more and who are therefore assumed to be better able to afford professional advice in the management of their affairs.

STRUCTURES AVAILABLE

The most common form of mutual fund vehicle is an exempted company (incorporated with limited liability), and is usually established in one of two ways, namely, by granting or not granting the investors voting rights in respect of their shares (other than in respect of an alteration of the rights attaching to their shares which they will always have a right to vote upon).

The use of a separate class of voting shares (usually issued to the promoter or investment manager) alongside non-voting shares issued to investors has the advantage for the promoter or investment manager of allowing minor changes to be made to the operating structure of the mutual fund (i.e. to the Articles of Association), without the need to call a meeting of the investors in circumstances where shares may be widely held. Disenfranchised shareholders retain the right to vote on matters affecting the rights attaching to their shares or by voting ‘with their feet’ by redeeming their shares.

Other vehicles used for regulated mutual funds include:

1. Exempted limited partnerships, under which the investors’ liability (as limited partners) is limited to their capital contributions, provided they do not take part in the conduct of the business of the partnership. Exempted limited partnerships are sometimes used in master-feeder structures but more typically for the unregulated closed-ended funds or private equity funds; and
2. Unit trusts, whereby investors (or unit holders) contribute funds to a trustee which holds those funds on trust for the unit holders, and each unit holder is directly entitled to share pro-rata in the trust’s assets.

TAXATION

The Cayman Islands currently has no direct taxation of any kind, including income, corporation, capital gains, withholding or death taxes. Under the terms of relevant legislation it is possible for all types of fund vehicles to apply to the government of the Cayman Islands for a written undertaking that they will not be subject to various descriptions of direct taxation, for a minimum period, which in the case of a company is currently 20 years and, in the case of a unit trust and limited partnership, 50 years.

The investment funds team at Stuarts Walker Hersant Humphries, Attorneys-at-Law is a market leader in advising managers on the set-up and establishment of a broad range of investment funds in the Cayman Islands, including hedge funds, real estate funds and private equity funds. ■