

Mutual funds in the Cayman Islands

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The Cayman Islands is one of the world's leading offshore jurisdictions for the establishment of investment funds. As at the end of Q4 2023, there were 12,800 open-ended investment funds (predominantly hedge funds) registered with the Cayman Islands Monetary Authority (**CIMA**) under the Mutual Funds Act (2021 Revision) (the **Mutual Funds Act**). There were also 16,550 private equity and other closed-ended funds registered in the Cayman Islands under the Private Funds Act (2021 Revision). For more details on Cayman Islands private equity and other closed-ended funds, please see our guide on [Private funds in the Cayman Islands](#). The remainder of this guide will focus on open-ended investment funds, referred to as '**mutual funds**'.

Key features of the Cayman Islands as a jurisdiction for mutual funds include:

- The flexibility of the mutual funds regime within a clear and effective regulatory environment.
- The quality and experience of the legal, administrative and accounting service providers.
- Ease of registration procedures.
- No requirement to have Cayman Islands-based directors or officers, managers, administrators or custodians.
- No restriction on commercial matters such as investment objectives, trading strategies or leverage, trading or diversification limits. Such commercial matters are for the mutual fund's sponsor to determine provided that full disclosure (and all associated risk factors) is made in the offering document.

Regulation of mutual funds

The Mutual Funds Act is the principal legislation relevant to the regulation of mutual funds in the Cayman Islands. All mutual funds must comply with relevant anti-money laundering legislation and regulation. CIMA is the regulatory body responsible for compliance with these regulations and has broad powers to ensure the protection of investors.

Definition of 'mutual fund'

The Mutual Funds Act defines a 'mutual fund' as a company, unit trust or partnership incorporated or otherwise carrying on business in the Cayman Islands that issues equity interests¹, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors to receive profits or gains from investments. The scope of regulation extends to Cayman Islands established or incorporated master funds which have one or more CIMA regulated feeder funds and hold investments and conduct trading

¹ **Equity interest** means a share, trust unit, partnership interest or any other representation of an interest that: (a) carries an entitlement to participate in the profits or gains of the company, unit trust or partnership; and (b) is redeemable or repurchasable at the option of the investor.

activities for the principal purpose of implementing the overall investment strategy of the regulated feeder fund.

Scope of the Mutual Funds Act

The following vehicles are excluded from the scope of the Mutual Funds Act:

- investment funds with only one investor, which fall outside the definition of a 'mutual fund' as there is no pooling of investor funds;
- single asset investment funds, which fall outside the definition of a 'mutual fund' as there is no spreading of investment risk; and
- private equity and other closed-ended funds that do not permit redemption or repurchase of interests at the option of the investor, which also fall outside the definition of 'mutual fund' but, as detailed above, are regulated by the Private Funds Act (2021 Revision).

Categories of regulation

The Mutual Funds Act contemplates five categories of regulated mutual funds: (1) licensed mutual funds, (2) administered mutual funds, (3) registered mutual funds, (4) limited investor funds and (5) EU connected funds.

1. Licensed mutual funds – Section 4(1)(a) of the Mutual Funds Act

This is the least common type of regulated mutual fund, as it involves an approval process such that the mutual fund itself is licensed (as opposed to being able to rely on the licence of the administrator in the case of administered mutual funds or being exempt from obtaining the licence in the case of registered mutual funds or limited investor funds). In granting a licence, CIMA will consider whether:

- each promoter is of sound reputation;
- the administration of the mutual fund will be undertaken by persons who have sufficient expertise and who are fit and proper to be directors, managers or officers (as the case may be); and
- the business of the fund and the offer of equity interests will be carried out in a proper manner.

This category of regulation is applicable to retail mutual funds.

2. Administered mutual funds – Section 4(1)(b) of the Mutual Funds Act

Instead of applying for its own licence, a mutual fund may seek to rely on the licence of a mutual fund administrator licensed pursuant to the Mutual Funds Act. This type of mutual fund is favoured by investment managers who wish to have a minimum initial subscription per investor that is lower than US\$100,000 and who expect that the mutual fund will have more than 15 investors, but who prefer not to go through the approval process outlined above.

An administered mutual fund is the only type of regulated mutual fund that must appoint a Cayman Islands licensed mutual fund administrator to provide its principal office in the Cayman Islands.

For an administered mutual fund, the selected administrator, as principal office provider, undertakes the responsibility of being satisfied of the same matters that CIMA considers for a licensed fund (outlined above). A licensed administrator must report to CIMA if it has reason to believe that a mutual fund for which it provides the principal office is acting in breach of the Mutual Funds Act, may be insolvent or is otherwise acting in a manner prejudicial to its creditors or investors.

3. Registered mutual funds and master funds – Section 4(3) of the Mutual Funds Act

Registered mutual funds, which are the most common type of mutual fund, and master funds² are exempt from the requirement to be licensed or administered on the basis that either (i) each investor must subscribe for equity interests in an amount not less than US\$100,000 or (ii) the equity interests of the mutual fund are listed on a stock exchange recognised by CIMA.

4. Limited investor funds – Section 4(4) of the Mutual Funds Act

Limited investor funds are mutual funds with fifteen investors or fewer, the majority of whom have the power to appoint or remove the operator of the mutual fund (ie the directors, the general partner or the trustee, as applicable). In contrast to registered mutual funds, there is no minimum subscription amount for equity interests. Limited investor funds were previously exempt from the licensing and registration requirements of the Mutual Funds Act. However, following the Mutual Funds (Amendment) Act, 2020, limited investor funds were required to register with CIMA.

5. EU connected funds – Section 22B of the Mutual Funds Act

Additionally, for the purpose of Cayman Islands funds qualifying for AIFMD passports, CIMA has an 'opt in' regime for mutual funds which wish to market in the EU or EEA. Such EU connected funds may elect to apply for a licence or registration under the Mutual Funds Act.

Requirements under the Mutual Funds Act

Offering documents

All mutual funds, other than master funds, must have a current offering document which describes the equity interests of the mutual fund in all material respects and contains all material information to enable a prospective investor to make an informed decision as to whether or not to subscribe.

Mutual funds are required to file their offering document with CIMA, together with the prescribed particulars. Master funds, which have no offering document, need only submit prescribed particulars to CIMA. The 'prescribed particulars' are set out in forms which summarise certain details from the offering document.

Offering documents (or in the case of a master fund, the prescribed particulars) must be updated within 21 days of any material change, and refiled with CIMA within such period.

Audited accounts

All mutual funds must file audited accounts (in electronic format) with CIMA within six months of the year end, together with an annual return form including prescribed details, signed by a director. Such audited financial statements must be signed-off by an approved Cayman Islands-based auditor. In practice, this causes little difficulty because all of the main accounting firms have offices in the Cayman Islands. The bulk of the preparatory work will invariably be done by the audit firm in the place in which the fund's records are physically located (usually the office of the manager or administrator) and then the Cayman Islands audit firm will sign-off on the audited financial statements.

Fees

Mutual funds must pay an initial application fee (approximately US\$366) upon licensing or registration and an annual fee upon licensing or registration and on or before 15 January of each subsequent year (currently

² **Master fund** means a company, partnership or unit trust that: (a) is established or incorporated, as the case may be, in the Islands; (b) issues equity interests to one or more investors; (c) holds investments and conducts trading activities for the principal purpose of implementing the overall investment strategy of the regulated feeder fund; (d) has one or more regulated feeder funds either directly or through an intermediary entity established to invest in the master fund; and (e) is not licensed under the Banks and Trust Companies Act (2021 Revision) or the Insurance Act, 2010, or registered under the Building Societies Act (2020 Revision) or the Friendly Societies Act (1998 Revision). **Regulated feeder fund** means a regulated mutual fund that conducts more than 51% of its investing in a master fund either directly or through an intermediary entity.

approximately US\$4,270 for funds other than registered master funds, for which the fee is approximately US\$3,050).

Corporate governance

CIMA's Statement of Guidance on Corporate Governance³ establishes key principles of good governance that must be observed by each Cayman Islands regulated mutual fund. Such principles require, *inter alia*, the board of directors or other governing body to properly oversee the activities of the mutual fund's service providers, suitably identify, disclose and manage all conflicts of interest and meet at least twice a year, or otherwise more frequently as determined by the size, nature and complexity of the fund.

Record retention

CIMA requires mutual funds to retain adequate records in accordance with the size of the fund, the manner in which it is structured, organised and managed, and the nature, volume and complexity of its transactions and commitments. Mutual funds should keep records of books of accounts and other financial affairs, together with records and policies in relation to accounting, organisation, employees, administration, risk management, incorporation, shareholder/board meeting minutes and resolutions, client communication, service providers, customer due diligence and annual returns made to CIMA.

Records should be kept up-to-date and retained in their original format for a minimum period of five years after the transaction date or any other period as stipulated by law.

Anti-money laundering requirements

The Cayman Islands anti-money laundering and countering the financing of terrorism (AML/CFT) regime requires mutual funds to maintain AML/CFT procedures as appropriate to the size of the fund. The requirements include:

- adoption of a risk-based approach to monitor investors and financial activities, together with adequate systems to identify risk (including checks against all applicable sanctions lists) in relation to persons, countries and activities of the mutual fund;
- observance of the list of countries which are non-compliant, or do not sufficiently comply, with the recommendations of the Financial Action Task Force;
- procedures for:
 - investor identification and verification
 - risk-management;
 - record-keeping;
 - suspicious activity reporting;
 - monitoring, and testing the systems for, compliance with AML/CFT and proliferation financing regulatory requirements; and
- other internal control and communication procedures (eg a risk-based independent audit function).

Mutual funds are also under an obligation to appoint named individuals to act as the anti-money laundering compliance officer (AMLCO), money laundering reporting officer (MLRO) and deputy money laundering reporting officer (DMLRO). The AMLCO and MLRO may be the same individual.

The role of a fund's AMLCO is to oversee the AML/CFT compliance function and ensure the effectiveness of the fund's AML/CFT systems, its adherence to applicable AML/CFT legislation/guidance and the day-to-day operation of the fund's AML/CFT policies and procedures. The MLRO is the point of contact for all internal suspicious activity reports and will in turn report suspicious activity to the competent authorities. The DMLRO's role is to discharge the MLRO functions in the absence of the MLRO.

³ CIMA's Statement of Guidance on Corporate Governance – Mutual Funds and Private Funds can be found [here](#).

Automatic exchange of financial information

The Cayman Islands has automatic exchange of information regimes in place for reporting under the US Foreign Account Tax Compliance Act (**FATCA**) and the OECD's common reporting standard (**CRS**). Cayman Islands vehicles classified as 'Cayman Reporting Financial Institutions' are subject to registration, reporting, due diligence and administrative obligations. In addition to the registration and reporting required:

- each 'Cayman Reporting Financial Institution' under CRS is also required to establish, maintain and implement written policies and procedures even where the performance of CRS obligations has been delegated to a third party;
- each entity required to register with the Cayman Islands Tax Information Authority (**TIA**) must appoint a 'principal point of contact' (the **PPOC**) for the TIA to communicate with and a person authorised to notify the TIA of any changes to the PPOC; and
- each entity registering with the IRS must appoint a 'Responsible Officer' who provides certifications regarding compliance with FATCA.

Structures available

Exempted companies

Exempted companies are the most common vehicle for mutual funds. The majority of Cayman Islands exempted companies issue shares of a stated par value (although no par value shares are permitted). Dividends or other distributions are payable to investors from amounts standing to the credit of an exempted company's share premium account, subject to the exempted company being solvent, even if no profits are available. Shares in a Cayman Islands exempted company may also be redeemed or repurchased out of capital, again subject to solvency considerations.

Directors of CIMA-registered mutual funds structured as exempted companies have annual registration or licensing requirements under the Directors Registration and Licensing Act (as amended) of the Cayman Islands, depending on their status in each case. Please refer further to our guide on [The Director Registration and Licensing Regime in the Cayman Islands](#) for further information.

Limited liability companies

A Cayman Islands limited liability company (**LLC**) is similar in many respects to a Delaware limited liability company. It is a hybrid entity which, essentially, combines the characteristics of a Cayman Islands exempted company with those of a Cayman Islands exempted limited partnership. Like an exempted company, it is a body corporate with separate legal personality, but unlike an exempted company, it does not have share capital. Member liability is limited, capital accounts are permitted, and the members are free to determine among themselves in the LLC agreement how profits and losses are allocated and how and when distributions are made, similar to the freedoms afforded to partners of an exempted limited partnership.

Unit trusts

Cayman Islands trust law is based on English common law and therefore interpreted according to English case law, as modified by any Cayman Islands case law. Under a unit trust arrangement 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.

Exempted limited partnerships

Whilst exempted limited partnerships tend to be the most common vehicle for private equity or other closed-ended funds, exempted limited partnerships are also often used as master funds (and sometimes as feeder funds) in master-feeder mutual fund structures. Cayman Islands exempted limited partnerships are governed by a combination of equitable and common law rules (based on English common law) and also statutory provisions, pursuant to the Exempted Limited Partnership Act (2021 Revision).

Taxation

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

Contacts

A full list of contacts specialising in investment funds law can be found [here](#).

This guide is only intended to give a summary and general overview of the subject matter. It is not intended to be comprehensive and does not constitute, and should not be taken to be, legal advice. If you would like legal advice or further information on any issue raised by this guide, please get in touch with one of your usual contacts. You can find out more about us, and access our legal and regulatory notices at [mourant.com](https://www.mourant.com). © 2024 MOURANT ALL RIGHTS RESERVED