Investment funds in the Cayman Islands

Last reviewed: February 2017

The Cayman Islands is one of the world’s leading offshore jurisdictions for the establishment of investment funds. As at December 2016, there were over 10,500 funds (predominantly hedge funds) registered with the Cayman Islands Monetary Authority (CIMA) under the Mutual Funds Law (the Mutual Funds Law). There are also significant numbers of private equity and other closed-ended alternative investment funds registered in the Cayman Islands but which are not required to register with CIMA.

Key features include:
- The flexibility of the investment fund 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-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 fund’s sponsor to determine provided that full disclosure of such matters (and all associated risk factors) is made in the offering document.

Regulation of investment funds

The Mutual Funds Law is the principal legislation relevant to the regulation of investment funds in the Cayman Islands. Investment managers based in the Cayman Islands will also need to comply with the Securities Investment Business Law (the SIB Law), and all investment funds and service providers must also 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 funds’

The Mutual Funds Law refers to investment funds as ‘mutual funds’ and as such defines a ‘mutual fund’ as a company, unit trust or partnership incorporated or otherwise carrying on business in the Cayman Islands that issues equity interests for the purpose of pooling investor funds, with the aim of spreading investment risk and enabling investors to receive profits or gains from investments. The scope of regulation extends to Cayman incorporated or established master funds which have one or more CIMA regulated feeder funds and hold investments and conduct trading activities. The remainder of this guide will refer to investment funds as ‘mutual funds’.

Scope of the Mutual Funds Law

The following exclusions or exemptions from the Mutual Funds Law apply:
- Funds with only one investor fall outside the definition of a ‘mutual fund’, as there is no pooling of investor funds.
• Closed-ended funds or private equity vehicles which do not permit redemption or repurchase of interests also fall outside the definition of ‘mutual fund’.

• Investment funds with fifteen investors or fewer, 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), are exempt from the licensing and registration provisions of the Mutual Funds Law. This exemption does not apply to Cayman Islands regulated master funds.

Categories of regulation

Three categories of mutual funds are required by the terms of the Mutual Funds Law to subject themselves to regulation by CIMA. Such mutual funds are referred to in this guide as: (a) the licensed mutual fund, (b) the administered mutual fund and (c) the registered mutual fund.

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

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 license of the administrator in the case of type (b) administered mutual funds or being exempt from obtaining the license in the case of type (c) registered mutual 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.

(b) Administered mutual funds – Section 4(1)(b) of the Mutual Funds Law

Instead of applying for its own licence, a mutual fund may seek to rely on the existing licence of a licensed mutual fund administrator based in the Cayman Islands. 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, but who prefer not to go through the approval process outlined above.

An administered mutual fund is the only type of regulated mutual fund which must appoint a mutual fund administrator based in the Cayman Islands. Licensed mutual funds and registered mutual funds may appoint an administrator in any jurisdiction.

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

(c) Registered mutual funds – Section 4(3) of the Mutual Funds Law

This is the most common type of investment fund registered with CIMA. Registered mutual funds 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 fund are listed on a stock exchange recognised by CIMA.

(d) EU connected funds

Additionally, for the purpose of Cayman Islands funds qualifying for AIFMD passports CIMA is working with the Ministry of Financial Services to create an ‘opt in’ regime for a new category of mutual fund which wishes to market in the EU or EEA. Legislation has been published for these purposes, but it is not yet in force.
Requirements under the Mutual Funds Law

- All mutual funds other than master funds must have a current offering document, which must describe the equity interests of the mutual fund in all material respects and must contain all material information to enable a prospective investor to make an informed decision as to whether or not to subscribe.
- All regulated mutual funds (unless it is a master fund which has no offering document) are required to file their offering document with CIMA, together with the prescribed particulars. Master funds which have no offering document must submit prescribed particulars to CIMA. The ‘prescribed particulars’ are set out in forms which summarise certain details from the offering document, as follows:
  - Licensed fund: Form MF3
  - Administered fund: Form MF2 and MF2A
  - Registered feeder fund: Form MF1
  - Registered master fund: Form MF4
- All regulated mutual funds must, so long as there is a continuing offering, update their offering documents (or in the case of a master fund, the prescribed particulars) within 21 days of any material change, and must re-file the updated offering document and/or the prescribed particulars with CIMA within such 21 day period.
- All regulated mutual funds must have their accounts audited annually, and such audited financial statements must be filed with CIMA within six months of the year end of the relevant mutual fund in electronic format, 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 Cayman. 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 audit firm will sign-off on the audited financial statements.
- All regulated mutual funds must pay an application fee and an annual fee each year in January (currently approximately US$4,270 for funds other than registered master funds, for which the fee is approximately US$3,050).

CIMA has released a Statement of Guidance which establishes key principles of good governance which 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 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.

Fund administrators

General licence

A fund administrator must obtain a mutual fund administrator’s licence to carry on business in the Cayman Islands in relation to mutual funds. Excluded from the definition of mutual fund administration are, inter alia, the activities of the general partner of a partnership and the provision of a registered office at which statutory and legal records are kept or company secretarial work is undertaken.

An applicant must satisfy CIMA that it:
- has available sufficient expertise to administer regulated investment funds;
- is of sound reputation; and
- will administer regulated funds in a proper manner.

A mutual fund administrator must maintain a net worth of at least US$490,000 and have a principal office in the Cayman Islands with two individuals or a body corporate resident or incorporated in the Islands as its agent.

A licensed mutual fund administrator may act for an unlimited number of funds.
Restricted licence

A mutual fund administrator may apply to administer a limited number of related mutual funds (currently a maximum of ten). A restricted licensee need only have a registered office in the Islands and there is no minimum net worth requirement.

Investment managers

An investment fund in the Cayman Islands is not required to have an investment manager based in the Cayman Islands. If, however, an entity wishes to establish itself as an investment manager in the Cayman Islands, it will need to comply with the provisions of the SIB Law. Broadly, the SIB Law provides that the investment manager will need to be licensed under the SIB Law unless it is managing the assets of only certain categories of high net worth or sophisticated investors, in which case it will be able to take advantage of an annual exemption filing instead. The exemption form must be filed in January each year and the annual exemption filing fee is approximately US$6,100. The definition of ‘sophisticated investors’ includes mutual funds regulated by CIMA, so that the majority of investment managers are in practice able to take advantage of the exemption filing. For further details see our guide on the SIB Law.

Structures available

Companies

Companies are the most common vehicle for open-ended mutual funds. The majority of Cayman Islands 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 a company’s share premium account, subject to the company being solvent, even if no profits are available. Shares in a Cayman Islands company may also be redeemed or repurchased out of capital, again subject to solvency considerations.

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 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.

Limited partnerships

Limited partnerships are the most common vehicle for closed-ended funds or private equity funds. They are also sometimes used in master-feeder structures. Cayman 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 Law.

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 types of fund vehicles – the company, the unit trust and the limited partnership – 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 twenty years and, in the case of a unit trust and limited partnership, fifty years.

Cayman investment funds and their service providers must comply with relevant anti-money laundering legislation. In Cayman the relevant provisions are contained in the Proceeds of Crime Law, the Money Laundering Regulations and CIMA’s Guidance Notes on the subject.
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