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Guide to Investment Funds in the Cayman Islands



Circle Partners is a global fund administrator providing a comprehensive range of fund administration and corporate services to investment funds.

Company profile

Established in 2000 with our first office in the Netherlands, we presently offer our fund services from the world's major financial jurisdictions. Our clients range from asset managers, banks to family offices and are primarily based in Europe, Asia and the Americas. We service both traditional and alternative investment funds, based onshore and offshore. Our fund accounting and investor services teams are supported by in-house legal and IT specialists. We use state-of-the-art accounting and shareholder systems, enabling easy processing of data and swift financial reporting to both fund managers and investors. Circle Partners is privately owned and fully independent.

WHY THE CAYMAN ISLANDS?

The Cayman Islands is a British overseas territory and has a history of stable government. It enjoys one of the highest standards of living in the Caribbean.

The British government retains responsibility for internal security, defence and external affairs. Cayman Islands law derives from English common law, supplemented by local legislation. The court system is well developed and experienced. Major civil cases are heard in the Grand Court with appeals to the Cayman Islands Court of Appeal and ultimately to the Privy Council in London.

There are no exchange control restrictions or regulations in the Cayman Islands. Funds can be freely transferred in and out of the territory in unlimited amounts. The Cayman Islands dollar is tied to the US dollar and the latter is freely accepted and used within the local economy.

Many of the world's leading banks have a presence in the Cayman Islands and all the leading accountancy firms are represented as well. Investors and asset managers doing business in the Cayman Islands also benefit from top quality professional service providers (attorneys, fund administrators, trust companies, company managers, etc.) with extensive experience.

Today, the Cayman Islands is one of the world's leading offshore jurisdictions and is particularly renowned for the establishment of investment funds. Cayman Islands entities are customarily used for transactions of all types, including equity, debt, insurance and capital markets transactions, in mergers and acquisitions and in joint ventures. The Cayman Islands Monetary Authority (CIMA) supervises and regulates a wide range of financial services, including banking, insurance and investment management.

Types of Cayman Islands entities

Below we give a brief summary of the main features of several Cayman Islands entities.

Companies

The most popular form of company for offshore operations, used by international investors, is the exempted company. Cayman Islands exempted companies have distinct legal

personality. They only need to have one shareholder and there is no minimum capital requirement. Shares can be issued in any currency and denomination. There is no minimum or maximum amount prescribed for authorised, issued or paid up share capital. A Cayman company is required to maintain a registered office in the Cayman Islands. Only the register of directors must be filed with the Register of Companies.

Shares in a Cayman Islands company may be redeemed or repurchased out of capital, subject to solvency considerations.

There is no statutory restriction on the issue of debt instruments by Cayman companies. Cayman Islands law recognises a number of different types of security interests over assets.

Management of a company is generally delegated to its board of directors on the terms of its constitutional documents which can be supplemented by a shareholders' agreement. Although a company's constitutional documents must be registered with the Cayman Islands Registrar of Companies, they are not publicly available.

Limited partnerships

A partnership registered as an exempted limited partnership (ELP) must have at least one general partner which, if an individual, is resident in the Cayman Islands, if a company, is incorporated in Cayman or registered as a foreign company, or, if a partnership, is registered in Cayman. The general partner is responsible for the conduct of the ELP business and is liable for the partnership's debts or obligation, save as otherwise specified in the limited partnership agreement.

An ELP does not have any separate legal identity distinct from its partners and therefore any property of the ELP held in the name of the general partner or in the name of the ELP will be deemed to be held on trust by the general partner as an asset of the ELP. Limited partners have a liability which is limited to the amount of capital committed to the partnership, unless they would actively take part in the conduct of the business of an ELP. In such case, they will risk to become liable for the debts and obligations of the ELP, if the ELP becomes insolvent.

Trusts

The Cayman Islands has a well established and flexible trusts regime allowing for privacy and asset protection, both in the

commercial and private wealth spheres. As an example, if a Cayman Islands incorporated trust company carries out "connected trust business" only it can register as a private trust company (PTC) with CIMA. The PTC has proved to be a particularly attractive structure for wealthy families who are, for example, sensitive to issues of confidentiality, or who wish to retain some control or influence over the administration of the trust assets, which may include shares in a family company. PTC's can also be used in a philanthropic or commercial context. For commercial purposes, especially where a special purpose vehicle (SPV) is incorporated for the purpose of a particular transaction, the Special Trusts (Alternative Regime) Law (STAR) can be used, so that the shares in the SPV are vested in the STAR trustee for the purpose of exercising its voting rights.

REGULATORY FRAMEWORK FOR INVESTMENT FUNDS

The regulation of investment funds established under Cayman Islands law, or which are administered or managed in the Cayman Islands, is largely governed by the provisions of the Mutual Funds Law (2013 Revision) (the "MFL").

The goal of the MFL is to apply an appropriate level of regulation to each mutual fund carrying on business in or from the Cayman Islands, depending on its circumstances and ultimate investor market. It is important to note that the MFL does not impose any restrictions on investment objectives, risks, target rates of return, leveraging or other commercial matters, given the institutional and sophisticated nature of the investors in Cayman funds. However, the MFL requires that a fund's offering memorandum describes comprehensively the equity interests and contains sufficient information on objectives, risks, fee structure, service providers, conflicts of interest etc. to enable an investor to make an informed decision.

There are no prohibitive licensing and regulatory provisions or stringent measures calling for local custodians, managers or directors as the legislation recognises that most service providers engaged in the industry are already regulated or controlled in their home jurisdiction.

The MFL defines a mutual fund as company, trust or partnership, incorporated or established in the Cayman

Global reach, local expertise and presence

Islands, or if outside the Cayman Islands, managed from the Cayman Islands, which issues equity interest redeemable or repurchaseable at the option of the investor, the purpose of which is the pooling of investors' funds with the aim of spreading investment risk and enabling investors to receive profits or gains from investments.

Therefore, closed-ended investment vehicles, whose equity interests are not redeemable at the option of the investor fall outside of the definition of a mutual fund and, accordingly, are not regulated under the MFL in any way.

CIMA is charged with the supervision and regulation of mutual funds and mutual fund administrators.

All regulated investment funds must qualify under the MFL before starting business. To do so, it may either obtain its own license, appoint a licensed mutual fund administrator in the

Cayman Islands to provide its principal office, or be registered if the target is a sophisticated investor, i.e. with a minimum investment of US\$ 100,000 (or equivalent in any other currency) per investor.

In addition, under the Cayman Islands Directors Registration and Licensing Law 2014, directors of (a) mutual funds regulated under the MFL and (b) companies registered as "Excluded Persons" under the Cayman Islands Securities Investment Business Law (2011 Revision) must register with, or obtain a license from CIMA.

Categories of regulated funds

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

Licensed mutual funds – Section 4(1)(a) of the MFL

This is the least common type of regulated mutual fund, as it involves an approval process such that the mutual fund itself is licensed.

In granting a license, 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.

Administered mutual funds – Section 4(1)(b) of the MFL

Instead of applying for its own license, a mutual fund may seek to rely on the existing license of a licensed mutual fund administrator based in the Cayman Islands. This type of mutual fund is favored 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 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.

Registered mutual funds – Section 4(3) of the MFL

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 locally 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.

General requirements for regulated mutual funds

All regulated mutual funds are required to:

- 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;
- file their offering document with CIMA, together with the prescribed particulars, whereby the 'prescribed particulars' are set out in forms which summarise certain details from the offering document, as follows:
 - a. Licensed fund: Form MF3
 - b. Administered fund: Form MF2 and MF2A
 - c. Registered feeder fund: Form MF1
 - d. Registered master fund: Form MF4

- update, so long as there is a continuing offering, their offering documents and/or prescribed particulars (in case of a master fund) within 21 days of any material change, and re-file the updated offering document and/or prescribed particulars with CIMA within such 21 day period.
- have their accounts audited annually and to file such audited financial statements with CIMA;
- pay an application fee and an annual fee each year in January.

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.

Exempted funds

Not all investment funds are regulated under the MFL. Exempt from regulation subject to sub-section 4(4) of the MFL are funds with equity interests (shares, partnership interests or units) held by no more than 15 investors who by majority are capable of appointing or removing the operators of the fund (i.e. directors, trustees and general partners). In order to meet this requirement, the power to appoint and remove directors etc. must be vested in a majority in number of investors, rather than a majority in terms of the value of the equity interests. Funds which are structured so that the investors are issued with a class of shares which carry participation rights but which do not carry voting rights will not qualify as exempted funds.

INVESTMENT FUND VEHICLES

The three vehicles commonly used for operating mutual funds are the exempted company, the unit trust and the exempted limited partnership.

Exempted company

The exempted company may redeem or repurchase its own shares and may therefore operate as an open-ended corporate fund. Closed-ended corporate funds can also be

established using the exempted company and it is a relatively straightforward procedure to convert from one to the other.

An exempted company can also be registered as an exempted segregated portfolio company ("SPC") with protected cells or portfolios. Once registered as an SPC, a number of segregated portfolios can be operated by the company, which each have the benefit of statutory segregation of their respective assets and liabilities. Such structures have been used for multi-class, umbrella and master-feeder mutual fund structures, as well as for multi-issuance platforms allowing single managers to establish funds with different profiles within a single structure or sponsors to employ a single vehicle into which they bring multiple managers to manage distinct funds.

Unit trust

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 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 trusts' assets.

Exempted limited partnerships

The exempted limited partnership can be formed as easily as the exempted company or the unit trust. Limited partnerships are the most common vehicle for closed-ended funds, such as private equity or real estate funds. 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 have no direct taxes of any kind. There are no corporation, capital gains, income, profits or withholding taxes. Under the terms of the relevant legislation, it is possible for exempted companies, unit trusts and limited partnerships to register with and apply to the Cayman Islands government for a written undertaking that they will remain tax-free for a minimum period (20 years in the case of exempted companies and 50 years in the case of unit trusts and limited partnerships).

KEY SERVICE PROVIDERS

Cayman funds, regulated under the MFL, will generally appoint the following functionaries, some of them compulsorily:

- investment manager;
- administrator;
- custodian;
- auditor;
- directors.

Investment manager

The primary service provider appointed by a fund is its investment manager or investment adviser. Its precise role will vary depending on the terms of the contract pursuant to which the investment manager is appointed and can range from managing the fund's assets to simply acting in an advisory capacity and leaving all investment decisions ultimately to the directors.

There is no requirement that the investment manager is Cayman Islands based. However, it is quite common for clients to establish a Cayman Islands based investment manager with the purpose of obtaining a tax deferral on part of the management and performance fees generated.

Administrator

For most mutual funds established in the Cayman Islands (which either have a minimum initial investment of not less than US\$100,000 or its currency equivalent, or are unregulated by CIMA), there is no requirement that the fund appoints a Cayman Islands based administrator. Where the fund is a regulated mutual fund, CIMA will require the administrator to file a consent letter confirming to CIMA the specific functions the administrator will be responsible for.

Custodian

A custodian is appointed by a fund to act as guardian of its assets pursuant to the terms of the relevant custodian agreement. A custodian will hold in custody all of the securities and cash of the fund. It may also collect dividends and other payments due in respect of the fund's assets. There is no requirement that a custodian be based in the Cayman Islands. If the custodian is based in the Cayman Islands, it may need to be regulated pursuant to the Mutual Funds Law if it has control of all or substantially all the assets of the mutual fund.

Auditor

Mutual funds usually appoint an auditor and, in the case of funds being regulated by CIMA, are obliged to do so. A regulated mutual fund must file accounts audited by an approved auditor within six months of its financial year end. Furthermore, the accounts of regulated funds are required to be audited by an approved Cayman Islands based audit firm.

In practice, the requirement for a local sign-off in Cayman Islands 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.

Directors

The Mutual Funds Law imposes on regulated mutual funds to appoint at least two directors, at least one of which should be approved by CIMA. Generally these should be individuals, although CIMA will permit a corporation to act as a director if such corporation is established in Cayman Islands and well-known to CIMA.

Directors should meet at least twice a year, either in person or via telephone/video conference call. Meetings should be more frequent if the circumstances or size, nature and complexity of the fund dictate, in order for responsibilities to be effectively fulfilled. Full, accurate and clear records should be kept of all meetings.

Generally speaking, directors of mutual funds are not personally liable for the debts, liabilities or obligations of the company except for those debts, liabilities or obligations which arise out of the negligence, fraud or breach of fiduciary duty on the part of an individual director, or an action not within his authority and not ratified by the company.

The Cayman Islands Directors Registration and Licensing Law sets out categories of persons and entities who may act as directors of regulated mutual funds under the Mutual Funds Law.

SET-UP TIME

It is generally impossible to predict the time-frame for launching a Cayman Islands fund. Many factors will play a role, not in the least the drafting of the fund's offering memorandum, the entering into agreements with service providers and the opening of bank and brokerage accounts. It takes approximately five business days to register a mutual fund with CIMA and four to six weeks to license a fund once all documentation has been received.

HOW CAN CIRCLE PARTNERS HELP YOU?

We are a global, independent fund administrator with over 15 years of experience in fund administration, fund set-up and fund structuring. We offer services from most of the world's major financial jurisdictions. We can provide investment managers with practical advice and assistance in setting up their fund in the Cayman Islands and introduce them to banks, brokers, auditors and legal advisers.

Our range of services includes:

- advice and assistance in setting-up Cayman investment funds;
- on-going corporate and legal support for the fund;
- fund accounting and administration services;
- registrar and transfer agency services; and
- financial, regulatory and tax reporting services.

Our office in the Cayman Islands has a dedicated team that is focused on delivering a responsive and personalized service and is committed to going the extra mile in satisfying our clients' needs and exceeding their expectations.

Global reach, local expertise and presence

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