

# Retail investment funds in the Cayman Islands: regulatory overview

Jarrod Farley, Carey Olsen

[global.practicallaw.com/3-501-3562](http://global.practicallaw.com/3-501-3562)

## MARKET OVERVIEW

### 1. What is the structure of the retail funds market? What have been the main trends over the last year?

#### Open-ended retail funds

The Cayman Islands are not primarily known as a retail fund jurisdiction. Its laws and regulations applicable to investment funds are geared mainly towards attracting institutional investors.

Open-ended funds established in or marketed to the public in the Cayman Islands (that is, funds where investors can voluntarily redeem their interests) are considered "mutual funds" under the Mutual Funds Law (MF Law) and therefore must be regulated by the Cayman Islands Monetary Authority (CIMA), unless they fall within a limited exception.

Three types of CIMA-regulated funds (Regulated Funds) can admit retail investors (that is, investors who invest less than USD100,000):

- Funds licensed under section 4(1)(a) of the MF Law (Licensed Funds).
- Funds licensed under section 4(1)(b) of the MF Law (Administered Funds), that is, funds for which a CIMA-licensed mutual fund administrator provides the principal office and has delegated regulatory responsibilities.
- Funds registered under section 4(3) of the MF Law (Registered Funds) by virtue of being listed on an approved stock exchange.

In theory, retail investors can also invest in unregulated mutual funds (Unregulated MFs). These are funds exempted from registration with CIMA under section 4(4) of the MF Law due to having 15 or fewer investors, a majority of whom can appoint and remove the operator of the fund (the directors, general partner or trustee, as applicable). It is impossible to be certain, but it can be inferred that being limited to 15 investors makes them generally unsuitable for marketing to retail investors and therefore statistically insignificant as retail funds.

Although investment fund regulation in the Cayman Islands is generally geared towards institutional investors, there is one exception to this. The Retail Mutual Funds (Japan) Regulations provide a compliance framework for Licensed Funds that will market to retail investors in Japan, enabling them to automatically comply with the applicable Japanese securities laws. However, these funds are merely a sub-set of Licensed Funds, which themselves only comprise 1% of Regulated Funds.

According to CIMA's latest statistical digest (for 2017) only 4% of Regulated Funds have a minimum required investment of less than USD50,000 and only 2% require a minimum investment between USD50,000 and USD100,000.

Between 31 December 2016 and 31 December 2017, the number of Licensed Funds declined by 6 (from 81 to 75) and the number of Administered Funds also declined by 14 (from 331 to 317).

#### Closed-ended retail funds

Closed-ended funds (that is, funds whose equity interests cannot be redeemed at the option of the investor), whether retail or non-retail, are currently not regulated by CIMA under the MF Law.

As unregulated vehicles, it is difficult to know how many closed-ended funds exist, and harder still to guess the number admitting retail investors. However, based on the author's experience and the fact that, as unregulated funds, they would presumably find it even more difficult to comply with retail marketing restrictions in other jurisdictions, the author believes the number of closed-ended funds admitting retail investors is statistically insignificant.

## REGULATORY FRAMEWORK AND BODIES

### 2. What are the key statutes, regulations and rules that govern retail funds? Which regulatory bodies regulate retail funds?

#### Open-ended retail funds

**Regulatory framework.** Open-ended funds are regulated by the Mutual Funds Law (see Question 1). The Retail Mutual Funds (Japan) Regulations also apply to Licensed Funds that market to retail investors in Japan (see Question 1).

Directors of corporate Regulated Funds are regulated by The Directors Registration and Licensing Law, as supplemented by The Directors Registration and Licensing (Registration and Licensing) Regulations.

The Securities Investment Business Law provides that the Cayman Islands Monetary Authority (CIMA) is responsible for the licensing and control of persons carrying on "securities investment business" in or from within the Cayman Islands (see Question 4).

All Cayman funds are required to comply with the Anti-Money Laundering Regulations (AML Regulations) and the Guidance Notes on the AML Regulations issued by CIMA (GNs).

Cayman funds are also subject to regulations made under the Tax Information Authority Law, which implement the US Foreign Account Tax Compliance Act (FATCA) and the Organisation for Economic Co-operation and Development's (OECD's) Common Reporting Standard (CRS). With some limited exceptions, open-ended retail funds must register with and report annually to the Tax Information Authority on any reportable accounts of investors under FATCA and CRS.

**Regulatory bodies.** CIMA is the regulatory body for open-ended retail funds (see Question 1).

#### Closed-ended retail funds

**Regulatory framework.** There is no regulatory framework for closed-ended retail funds in the Cayman Islands (see Question 1). However, closed-ended funds are subject to the same AML compliance obligations and FATCA/CRS reporting requirements as open-ended funds.

---

**Regulatory bodies.** There is no regulatory body for closed-ended retail funds in the Cayman Islands (see *Question 7*). However, CIMA does have power to impose administrative penalties on any type of fund that is not complying with the AML Regulations.

---

### 3. Do retail funds themselves have to be authorised or licensed?

---

#### Open-ended retail funds

The following types of open-ended fund can admit retail investors (see *Question 7*):

- Licensed Funds.
- Administered Funds.
- Registered Funds listed on an approved stock exchange.
- Unregulated Mutual Funds (MFs).

Of the four types, only Unregulated MFs are not required to be regulated by the Cayman Islands Monetary Authority (CIMA). The licensing and registration requirements for Regulated Funds are set out below.

Any proposed director of a corporate fund regulated by CIMA must register with CIMA under the Directors Registration and Licensing Law (via CIMA's online registration portal) before he can be appointed.

**Licensed Funds.** A Licensed Fund must have either:

- For companies or limited partnerships: a registered office in the Cayman Islands.
- For unit trusts: a trustee that is a trust company licensed under the Banks and Trust Companies Law.

To apply to be licensed as a Licensed Fund, the following must be submitted to CIMA:

- An offering document (or the latest draft) describing the offered interests in all material respects and containing any other information necessary for an investor to make an informed investment decision (CIMA prescribes certain information that must be included).
- A completed application (Form MF3).
- A certified copy of the certificate of incorporation or registration.
- Completed personal questionnaires, three references and police clearance certificates (or affidavit of no convictions for certain individuals) for:
  - directors of the fund (for a company);
  - directors of the fund's trustee (for a unit trust); or
  - the fund's general partner or the general partner's directors, as applicable (for a limited partnership).
- Background details on the fund's service providers, if not included in the offering document.
- For an existing fund, a copy of the most recent annual audited accounts.
- A consent letter from an approved local auditor.
- A consent letter from an administrator.
- The prescribed licence fee (USD4,268.29) and application fee (USD365.85).
- Details of who will be responsible for dealing with queries from CIMA and the payment of fees (such as the registered office provider or local administrator).

CIMA must be satisfied that:

- Each promoter of the fund is of sound reputation (a promoter is any person responsible for preparation and distribution of the fund's offering document other than its professional advisers).
- The fund's administration will be undertaken by persons:
  - with sufficient expertise;
  - of sound reputation; and
  - who are fit and proper to be in their respective positions.
- The fund's business and any offering of its interests will be carried out in a proper way.

CIMA may grant a licence subject to any conditions that it considers appropriate.

**Administered Funds.** An Administered Fund must have a principal office in the Cayman Islands provided by a CIMA-licensed mutual fund administrator.

To register as an Administered Fund, the following must be submitted to CIMA:

- An offering document (or the latest draft) describing the offered interests in all material respects and containing any other information necessary for an investor to make an informed investment decision.
- Completed application (Forms MF2 and MF2A).
- A certified copy of the certificate of incorporation (or equivalent).
- A consent letter from an approved local auditor.
- The prescribed registration fee (USD4,268.29) and application fee (USD365.85).

The administrator providing the fund's principal office must be satisfied that:

- Each promoter of the fund is of sound reputation.
- The fund's administration will be undertaken by persons with sufficient expertise and who are of sound reputation.
- The fund's business and any offering of its interests will be carried out in a proper way.

**Registered Funds.** To admit retail investors, a Registered Fund must be listed on an approved stock exchange.

To register as a Registered Fund, the following must be submitted to CIMA:

- An offering document (or the latest draft) describing the offered interests in all material respects and containing any other information necessary for an investor to make an informed investment decision.
- A completed application Form MF1.
- A certified copy of the certificate of incorporation or registration.
- A consent letter from an approved local auditor.
- A consent letter from an administrator.
- The prescribed registration fee (USD4,268.29) and application fee (USD365.85).
- Details of who will be responsible for dealing with queries from CIMA and the payment of fees (such as the registered office provider or local administrator).

#### Closed-ended retail funds

There are no regulatory licensing requirements for closed-ended funds (see *Question 7*, Closed-ended retail funds).

---

## MARKETING

---

### 4. Who can market retail funds?

---

#### Open-ended retail funds

The Securities Investment Business Law (SIB Law) provides for the licensing and control of persons carrying on "securities investment business" in or from within the Cayman Islands by the Cayman Islands Monetary Authority (CIMA). Securities investment business includes dealing in, arranging deals in and advising on securities. Accordingly, the marketing of interests in funds will generally constitute securities investment business.

With limited exceptions for public authorities and so on, the SIB Law applies to:

- Any entity formed or registered in the Cayman Islands carrying on securities investment business.
- Any person that establishes a place of business in the Cayman Islands from which securities investment business is carried out.

Any of the foregoing will require a licence under the SIB Law to carry on securities investment business, unless the entity or person:

- Qualifies to register as a "registered person".
- Files an application form and fee (USD6,097.56) to register with CIMA before commencing securities investment business (and by 15 January each year thereafter).
- Satisfies CIMA that its shareholders, directors and senior officers are fit and proper persons.

An entity or person will qualify to register as a registered person if:

- It only carries on securities investment business with:
  - group companies (that is, other companies within the same group of companies);
  - sophisticated persons, that is persons who are regulated by CIMA or by a recognised overseas regulatory authority; have securities listed on a recognised security exchange; or have the knowledge and are capable of evaluating the merits of a proposed transaction with a value of at least USD100,000.
- High net worth persons, meaning individuals with a net worth of at least USD1 million or any person with total assets of at least USD5 million.
- Entities in which the investors are all sophisticated or high net worth persons.
- It is a person regulated in relation to securities investment business by a recognised overseas regulatory authority.

#### Closed-ended retail funds

The position is the same as for open-ended retail funds (*see above, Open-ended retail funds*).

---

### 5. To whom can retail funds be marketed?

---

#### Open-ended retail funds

If incorporated as an exempted company or a limited liability company (LLC), a fund's securities cannot be offered to the public in the Cayman Islands unless listed on the Cayman Islands Stock Exchange.

Any other type of Regulated Fund or an Unregulated MF can market its interests to the public in the Cayman Islands through a person appropriately licensed under the Securities Investment Business

Law (SIB Law). Outside the Cayman Islands any local limitations on the marketing of retail fund securities will apply.

Overseas open-ended funds that do not register with the Cayman Islands Monetary Authority (CIMA) as a Regulated Fund, can only market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law, and provided that either:

- The interests are listed on a stock exchange approved by CIMA.
- The fund is regulated in a category and by an overseas regulator approved by CIMA.

However, for this purpose, "public in the Cayman Islands" does not include the following categories of person (meaning an overseas fund will not be restricted in marketing to them from outside the Cayman Islands):

- Sophisticated persons (as defined in the SIB Law) (*see Question 4*).
- High net worth persons (as defined in the SIB Law) (*see Question 4*).
- Entities in which all the investors are sophisticated or high net worth persons.
- Exempted or ordinary non-resident Cayman Islands companies, LLCs, or any director or officer of the same acting in such capacity.
- Overseas companies registered as foreign companies in the Cayman Islands, or any director or officer of the same acting in such capacity.
- Any Cayman Islands LLC, exempted, ordinary non-resident or foreign company acting as general partner of a Cayman Islands exempted limited partnership, or any director or officer of the same acting in such capacity.
- The trustee of any Cayman Islands exempted trust.
- From January 2019, it has been possible for any Cayman funds to voluntarily register with CIMA as EU Connected Funds (that is, funds managed from or marketed into EU/EEA member states that have implemented AIFMD). For unregulated funds, this makes them subject to the same level of regulation as Regulated Funds. Such registrations facilitate the attestation of regulated status by CIMA to EU/EEA regulators.

#### Closed-ended retail funds

Closed-ended funds can market their interests to the public in the Cayman Islands through a person appropriately licensed under the SIB Law. Closed-ended funds can register as EU Connected Funds to facilitate marketing in the EU/EEA.

Overseas closed-ended funds can freely market their interests to the public in the Cayman Islands provided they do so from outside the Cayman Islands, and not from a place of business in the Cayman Islands.

---

## MANAGERS AND OPERATORS

---

### 6. What are the key requirements that apply to managers or operators of retail funds?

---

#### Open-ended retail funds

The following key requirements apply to managers and operators of open-ended funds:

- A corporate Regulated Fund or the corporate general partner of a limited partnership Regulated Fund must have at least two directors.

- All the directors of a corporate Regulated Fund must be registered with the Cayman Islands Monetary Authority (CIMA) under the Directors Registration and Licensing Law.
- The trustee of a Licensed Fund must be licensed under the Banks and Trust Companies Law.
- Investment managers incorporated or registered in the Cayman Islands must generally be regulated under the Securities Investment Business Law (SIB Law) (see Question 4).
- Any director, manager or officer of a fund regulated by CIMA must be a "fit and proper person", as determined by reference to this person's:
  - honesty, integrity and reputation;
  - competence and capability; and
  - financial soundness.
- Managers of open-ended retail funds will (if they are established in the Cayman Islands) be subject to regulations made under the Tax Information Authority Law, which implement the US Foreign Account Tax Compliance Act (FATCA) and the OECD's Common Reporting Standard (CRS). Managers will generally be exempt from registration and reporting requirements under FATCA, but must register under CRS, even though they will usually have not reportable accounts.

#### Closed-ended retail funds

Investment managers of closed-ended funds, if incorporated or registered in the Cayman Islands, will generally be carrying on securities investment business and require regulation under the SIB Law, unless the fund does not invest in "securities" (as defined in the SIB Law).

Managers of closed-ended retail funds will (if they are established in the Cayman Islands) be subject to the same FATCA and CRS obligations as managers of open-ended retail funds. From January 2020, discretionary managers of securities (if they are established in the Cayman Islands) will also be subject to requirements under the Economic Substance Law, that they conduct all their core income generating activities in the Cayman Islands.

### ASSETS PORTFOLIO

#### 7. Who holds the portfolio of assets? What regulations are in place for its protection?

##### Open-ended retail funds

Licensed Funds to which the Retail Mutual Funds (Japan) Regulations apply must appoint a custodian in an approved jurisdiction.

Apart from this exception, there are currently no rules requiring the appointment of a custodian or broker to hold a fund's portfolio assets.

##### Closed-ended retail funds

There are no restrictions applicable to closed-ended funds.

### LEGAL FUND VEHICLES

#### 8. What are the main legal vehicles used to set up a retail fund and what are the key advantages and disadvantages of using these structures?

##### Open-ended retail funds

Legal vehicles. Open-ended funds can be formed as:

- **Companies.** The exempted company limited by shares is the most commonly used vehicle for regulated open-ended funds (historically accounting for around 75% of Regulated Funds). Most of these are standard exempted companies, but around 10% of such companies are segregated portfolio companies (in which separate portfolios can be created with assets and liabilities that are legally ring-fenced). LLCs were introduced in June 2016 but so far have mainly been used as the vehicle for general partners of limited partnership funds vehicles, not as the fund vehicles themselves.
- Exempted companies and their shares are widely understood and in addition to a body of Cayman Islands jurisprudence, the Cayman Islands courts can draw on a long tradition of relevant case law from England and the rest of the Commonwealth. A company has legal personality separate from its shareholders and can issue shares in different classes and series. A shareholder's liability for the company's debts is limited by statute to the amount unpaid on its shares (which in an investment fund will usually be issued fully paid).
- **Limited partnerships.** These are registered under The Exempted Limited Partnership Law. Cayman Islands exempted limited partnerships are underpinned by English partnership law, but are modified by statute to make them more suitable for use as investment funds. For example, exempted limited partnerships, while not having separate legal personality, can sue and be sued in their own name.
- **Unit trusts.** These are governed by the Trusts Law. Unit trusts are underpinned by English trust law, but are modified by statute to make them more suitable for use as investment funds. For example, STAR trusts (Special Trusts - Alternative Regime) are not subject to any perpetuity period and can have purposes as their objects.

**Advantages/disadvantages.** The key advantages and disadvantages of the different types of vehicle are:

- **Flexibility.** Companies are generally governed by more rigid rules than those applicable to limited partnerships and unit trusts (for example, in relation to provisions regarding maintenance of capital, the method of changing their constitutional documents and so on).
- **Legal personality.** Companies have separate legal personality, while limited partnerships must operate through their general partner, and unit trusts through their trustee.
- **Additional vehicles.** Exempted limited partnerships require at least one general partner that is established or registered in the Cayman Islands and unit trusts require a trustee, who will usually insert a controlled subsidiary for liability protection.
- **Regulatory requirements.** A Licensed Fund that is a unit trust requires a trustee licensed under the Banks and Trust Companies Law.
- **Overseas requirements.** The choice of vehicle will often depend on whether it can qualify for specific tax or regulatory treatment in an overseas jurisdiction (for example, unit trusts are generally used for the Japanese market and limited partnerships for the Israeli market).

##### Closed-ended retail funds

The position is the same as for open-ended funds (see above, *Open-ended retail funds*).



---

## INVESTMENT AND BORROWING RESTRICTIONS

---

### 9. What are the investment and borrowing restrictions on retail funds?

---

#### Open-ended retail funds

There are no statutory investment or borrowing restrictions on open-ended funds.

#### Closed-ended retail funds

The position is the same as for open-ended funds (*see above, Open-ended retail funds*).

---

### 10. Can the manager or operator place any restrictions on the issue and redemption of interests in retail funds?

---

#### Open-ended retail funds

Open-ended funds can agree any restrictions on the issue and redemption of interests with their investors at the time they subscribe for such interests. The introduction of additional restrictions in respect of an investor's existing interests can only be achieved in accordance with the consent mechanisms contained in the fund's constitutional documents.

#### Closed-ended retail funds

The position for closed-ended retail funds is the same as for open-ended funds (*see above, Open-ended retail funds*).

---

### 11. Are there any restrictions on the rights of participants in retail funds to transfer or assign their interests to third parties?

---

#### Open-ended retail funds

There are no statutory restrictions on the ability of participants in open-ended funds to transfer or assign their interests to third parties. However, the constitutional documents of such funds usually contain restrictions, except where the interests are listed on a stock exchange. In practice, transfers are generally be conditional on the transferee supplying the information required for a fund to comply with its AML due diligence and FATCA/CRS reporting obligations.

#### Closed-ended retail funds

The position for closed-ended retail funds is the same as for open-ended funds (*see above, Open-ended retail funds*).

---

## REPORTING REQUIREMENTS

---

### 12. What are the general periodic reporting requirements for retail funds?

---

#### Open-ended retail funds

If the fund is regulated by the Cayman Islands Monetary Authority (CIMA), it must file the following with CIMA within six months of the end of each financial year:

- Audited financial statements (audited by an approved local auditor).
- Fund Annual Return (one for each sub-fund, if applicable).

#### Closed-ended retail funds

Closed-ended funds have no statutory reporting requirements.

#### Tax treatment

---

### 13. What is the tax treatment for retail funds?

---

#### Open-ended retail funds

There is no Cayman Islands tax applicable to payments made to or from an open-ended fund.

#### Closed-ended retail funds

There is no Cayman Islands tax applicable to payments made to or from a closed-ended fund.

#### Quasi-retail funds

---

### 14. Is there a market for quasi-retail funds in your jurisdiction?

---

The author is not aware of any significant market for quasi-retail funds.

## REFORM

---

### 15. What proposals (if any) are there for the reform of retail fund regulation?

---

The author is not aware of any proposals to reform retail fund regulation.

---

## Practical Law Contributor profile

---

### Jarrod Farley, Partner

---

Carey Olsen

**T** +1 345 749 2004

**F** +44 1481 739081

**E** jarrod.farley@careyolsen.com

**W** www.careyolsen.com

**Professional qualifications.** England and Wales, Solicitor, 2000 (non-practising); Cayman Islands, Attorney-at-law, 2004

**Areas of practice.** Corporate and commercial; investment funds and private equity; mergers and acquisitions.

**Non-professional qualifications.** BA in Ancient and Modern History, Oxford University

#### Recent transactions

- Launching a platform of regulated Cayman Islands funds for the US investment management arm of a French bank.
- Advising a German acquirer on its USD625m acquisition of a US target, structured by way of a Cayman Islands merger.
- Advising an SEC regulated manager on updating its AML manuals for its Cayman Islands managed funds.
- Migrating a Nasdaq listed company from Curacao to the Cayman Islands.
- Advising an Israeli fund manager on the launch of a USD400 million private equity fund.
- Advising on multiple fund financings secured against capital calls for fund clients.
- Advising on multiple open-ended and closed-ended fund launches for existing and new manager clients.