

CAYMAN ISLANDS INVESTMENT FUNDS

NOVEMBER 2013

INVESTMENT
FUNDS & PRIVATE
EQUITY

WWW.CAREYOLSEN.COM

BRITISH VIRGIN ISLANDS
CAYMAN ISLANDS
GUERNSEY
JERSEY
CAPE TOWN
LONDON



INTRODUCTION

The Cayman Islands are the jurisdiction of choice for managers looking to establish an offshore fund, whether a hedge fund, a private equity fund or a hybrid fund. One of the advantages of the Cayman Islands is that only investment funds which are open-ended (i.e. funds where the interests, shares or units (collectively, “**Interests**”) are redeemable at the option of the investor) are required to be regulated in the Cayman Islands under the Mutual Funds Law (as revised) of the Cayman Islands (the “**Mutual Funds Law**”). This means that there are no regulatory obligations with respect to closed-ended funds (i.e. funds with no redemption rights or a substantial lock-up period). Accordingly, generally only hedge funds are required to comply with the Mutual Funds Law; most private equity funds generally fall outside of its scope.

The most popular forms of Cayman Islands investment fund vehicles, by a significant margin, are the exempted company and the segregated portfolio company (each, a “**Company**”) incorporated under the Companies Law (as revised) of the Cayman Islands (the “**Companies Law**”) and the exempted limited partnership (a “**Partnership**”) registered under the Exempted Limited Partnership Law (as revised) of the Cayman Islands (the “**ELP Law**”). Although less frequently used, it is also possible to structure an investment fund as a Cayman Islands unit trust (a “**Unit Trust**”).

MUTUAL FUNDS LAW

General

The overwhelming majority of open-ended funds which are required to register with the Cayman Islands Monetary Authority (“**CIMA**”) under the Mutual Funds Law register under section 4(3) of that law (each a “**Registered Fund**”). The main requirement of a Registered Fund is that each investor must make an initial investment of at least US\$100,000 (or the equivalent in another currency). It is also possible to register an investment fund as a licensed fund or an administered fund under the Mutual Funds Law but these are less common and outside of the scope of this legal guide.

Exemptions from Registration

The following investment funds (save in the case of Master Funds (as defined below)), are not required to register under the Mutual Funds Law:

- funds with no redemption rights or a substantial lock-up period (usually more than five years);
- single-investor funds (because there is no “pooling” of investor funds); and
- open-ended funds where: (i) the Interests are held by 15 or fewer investors; and (ii) a majority in number of such investors are able to appoint or remove the directors/general partner/trustee of the fund (each an “**Operator**”).

Registration Requirements

In order to register an investment fund as a Registered Fund with CIMA, the Operator will need to:

- establish a Company, Partnership or Unit Trust (and prepare the constitutional documents of such vehicle);

- prepare an offering document (an “**Offering Document**”), a subscription agreement, service provider agreements and other documents required in connection with the offering of Interests;
- appoint an administrator, an “approved” auditor (a list of approved auditors can be found on CIMA’s website www.cimoney.com.ky) and any other service providers (e.g. legal counsel, prime brokers, bankers or custodians);
- ensure that the minimum initial subscription amount is not less than US\$100,000; and
- file the Offering Document, consent letters from the auditor and the administrator, Form MF1 and a notarised copy of the CIMA Connect affidavit with CIMA and pay a registration fee of approximately US\$4,600.

Contents of the Offering Document

The Mutual Funds Law requires that an Offering Document: (i) describe the Interests in all material respects; and (ii) contain such other information as is necessary to enable a prospective investor in the fund to make an informed decision as to whether or not to subscribe for or purchase the Interests. Informal guidance provided by CIMA in the past has highlighted that the foregoing requirements translate into a description of at least the following:

- the investment objectives of the fund (and any investment restrictions);
- the minimum initial investment of US\$100,000 required from each investor;
- the classes and series of Interests to be issued;
- subscription and redemption policies and procedures;
- the valuation methodology and the calculation of net asset value;
- the Operator(s) (including biographies);
- the fund’s service providers (including their addresses) and their roles;
- risk factors and conflicts of interest;
- regulation under the Mutual Funds Law;
- anti-money laundering requirements;
- the financial year-end of the fund; and
- details of where material documents relating to the investment fund may be viewed or obtained.

Most Offering Documents will obviously contain significantly more information than the minimum requirements set out above and an Operator ought to be aware of the potential liability involved in issuing an incomplete or inaccurate Offering Document. See “Liability in Respect of Offering of Interests” below for more information on this point.

Directors

If the Registered Fund is structured as a Company, CIMA requires that the fund has at least two directors. There are no requirements as to the nationality or residence of the Directors. It is also common, but not obligatory, for a Registered Fund to appoint one or more “independent directors” (i.e. directors not affiliated with the investment manager of the fund).

Service Provider Requirements

Aside from the appointment of an approved local auditor, there are no requirements or restrictions as to a Registered Fund's service providers.

Anti-Money Laundering Obligations

A Registered Fund is automatically subject to Cayman Islands anti-money laundering legislation. The main legislation governing anti-money laundering in the Cayman Islands is the Proceeds of Crime Law (as revised) as supplemented by the Money Laundering Regulations (as revised) and the associated guidance notes issued by CIMA (collectively, the "**Anti-Money Laundering Legislation**"). In general, a Registered Fund which has no employees in the Cayman Islands will delegate its anti-money laundering obligations under the Anti-Money Laundering Legislation ("**AML Obligations**") to its administrator. This is only permissible where the administrator is: (i) based in the Cayman Islands or a jurisdiction that CIMA has recognised as having equivalent anti-money laundering legislation to the Cayman Islands; and (ii) subject to the anti-money laundering regime of that jurisdiction. If a Registered Fund is not able to delegate its AML Obligations to its administrator, or it has employees in the Cayman Islands, specific advice should be sought from your usual contact at Carey Olsen. In addition, although the Operator may have delegated the AML Obligations to the administrator, it should be noted that the Operator will still remain ultimately responsible for ensuring that the Registered Fund complies with its AML Obligations. In order to ensure that the Operator is fulfilling its duties, it should at the very least satisfy itself that:

- the AML Obligations have been formally delegated to the administrator in the administration agreement;
- relevant records are being maintained by the administrator and are available to CIMA, the Financial Reporting Unit and law enforcement authorities in accordance with relevant procedures; and
- the administrator's systems and procedures are reliable. This should be done on an ongoing and regular basis.

Continuing Obligations

An Operator will need to ensure that the Registered Fund complies with its continuing obligations under the Mutual Funds Law, the Anti-Money Laundering Legislation and all other laws applicable to the fund. This includes the continuing obligations of the fund under the Companies Law, the ELP Law or the Trusts Law (as revised) of the Cayman Islands and the following obligations under the Mutual Funds Law:

- if there is a continuing offering of Interests and the Operator is aware of any change that materially affects any information in the Offering Document or Form MF1, the Operator must ensure that notice of any such change is notified to CIMA and a revised Offering Document, a supplement to the Offering Document or a revised Form MF1 is filed with CIMA (if applicable);

- a Registered Fund is required to ensure that its audited financial statements are filed with CIMA within 6 months of its financial year end. Failure to have the Registered Fund's financial statements audited or failure to file these within the necessary timeframe may result in the Operator being fined up to approximately US\$24,000; and
- an annual fee of approximately US\$4,200 must be paid to CIMA before 15 January in each year or penalties will accrue.

Supervision by CIMA

Registered Funds are subject to the supervision of CIMA and CIMA may at any time instruct a Registered Fund to have its accounts audited and to submit them to CIMA within such time as CIMA specifies. Failure to comply with these requests by CIMA may result in substantial fines on the part of the Operator and may result in CIMA applying to the Cayman Islands courts to have the fund wound up and dissolved. In addition, CIMA may take certain actions if it is satisfied that a Registered Fund is or is likely to become unable to meet its obligations as they fall due or is carrying on or is attempting to carry on business or is winding up its business voluntarily in a manner that is prejudicial to its investors or creditors. The powers of CIMA include the power to require the substitution of the Operator, to appoint a person to advise the fund on the proper conduct of its affairs or to appoint a person to assume control of the affairs of the fund. There are other remedies available to CIMA including the ability to apply to the Cayman Islands courts for approval of other actions.

Penalties

An Operator of a Registered Fund may be fined up to approximately US\$120,000 if it fails to: (i) register under the Mutual Funds Law when required to do so; or (ii) file changes to the Offering Document or Form MF1 with CIMA within 21 days.

REGISTRATION OF MASTER FUNDS

Where a Registered Fund forms part of a master/feeder structure the master fund (the "Master Fund") will also need to register under the Mutual Funds Law. The exemptions in respect of single-investor funds and "15 or fewer investors" funds do not apply to Master Funds. Registration as a Master Fund is a more streamlined procedure than the registration for a Registered Fund. Assuming that (as is customary) a Master Fund does not have its own Offering Document but that it has the same administrator and auditors as the Registered Fund and the minimum aggregate equity interest purchasable by a prospective investor is at least US\$100,000, registration simply involves filing the Form MF4 and a notarised copy of the CIMA Connect affidavit with CIMA and paying a registration fee of approximately US\$3,000.

LIABILITY IN RESPECT OF OFFERING OF INTERESTS

The Operator of a Registered Fund must be comfortable that the Offering Document is accurate and complete in all material respects and that it does not contain any statement which may mislead a prospective investor. Liability for the Registered Fund (and possibly its Operator) for an inaccurate, incomplete or misleading Offering Document may arise

under one or more of the following:

Misrepresentation

The Offering Document ordinarily forms part of the investor's contract with the Registered Fund in respect of such investor's subscription for Interests. If the Offering Document contains a misrepresentation then an investor may have a claim under the Contracts Law (as revised) of the Cayman Islands (the "Contracts Law") or under Cayman Islands common law.

- *Contracts Law.* Section 14 of the Contracts Law states as follows:
"Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was not made fraudulently unless he proves that he had reasonable grounds to believe and did believe up to the time the contract was made that the facts represented were true. Where a person has entered into a contract after misrepresentation has been made to him otherwise than fraudulently, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded, the court may declare the contract subsisting and award damages in lieu of rescission, if of opinion that it would be equitable so to do, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party."
- *Common Law.* If an investor subscribed for Interests in reliance upon a misrepresentation in the Offering Document, then the investor may be entitled to rescind the contract for his subscription for Interests and/or sue the fund for damages.

Breach of Contract

An investor may bring a claim for breach of contract against the Registered Fund.

Tort

A subscriber could bring an action in tort against the Registered Fund and/or the Operator. This could be under one or more of the following torts: (i) negligent misstatement; (ii) fraudulent misstatement; or (iii) deceit.

Penal Code

The Penal Code provides that a person who:

- issues a written statement (with intent to deceive shareholders or creditors) which is misleading, false or deceptive may be imprisoned for up to seven years;
- dishonestly obtains property belonging to another by deception may be imprisoned for up to ten years; and
- dishonestly obtains for himself or another any pecuniary advantage by deception may be imprisoned for up to five years.

COSTS

Your usual contact at Carey Olsen will be able to provide you with an estimate of the costs of establishing an investment fund in the Cayman Islands.

CONTACT US

For further information or professional advice please contact our lawyers below.

CAYMAN ISLANDS

T +1 345 749 2000

PO Box 10008, Willow House, Cricket Square,
Grand Cayman, KY1-1001, Cayman Islands



JARROD FARLEY
Managing Partner

T +1 345 749 2004
E jarrod.farley@careyolsen.com



NICK BULLMORE
Partner

T +1 345 749 2012
E nick.bullmore@careyolsen.com



ANTHONY MCKENZIE
Partner

T +1 345 749 2001
E anthony.mckenzie@careyolsen.com

“Carey Olsen” in the Cayman Islands is the business name of Carey Olsen Cayman Limited, a body corporate recognised under the Legal Practitioners (Incorporated Practice) Regulations (as revised). The use of the title “Partner” is merely to denote seniority. Services are provided on the basis of our current terms of business, which can be viewed at: www.careyolsen.com/images/uploads/careyolsen_termsofbusiness.pdf.

CO Services Cayman Limited is regulated by the Cayman Islands Monetary Authority as the holder of a corporate services licence (No. 624643) under the Companies Management Law (as revised).

Please note that this briefing is only intended to provide a very general overview of the matters to which it relates. It is not intended as legal advice and should not be relied on as such.

© Carey Olsen 2013