Charles Adams Ritchie & Duckworth
ATTORNEYS AT LAW

CAYMAN ISLANDS INVESTMENT FUNDS

INTRODUCTION

This memorandum summarises the methods of establishing investment funds in the Cayman Islands and highlights the principal legal and regulatory considerations. It is not intended to deal exhaustively with all aspects of the subject and proper legal advice should be obtained before proceeding with the establishment of a particular fund.

The Cayman Islands, with over 6,500 regulated and many more unregulated funds currently in existence, have become a jurisdiction of choice for the establishment of hedge and other investment funds. The laws of the Cayman Islands allow a high degree of flexibility and permit mutual funds to be structured as companies, unit trusts or limited partnerships. Funds may be established for all categories of investor but the Cayman Islands are particularly well suited for private placement funds intended for institutional or sophisticated high net worth investors because:

- the regulatory regime is designed to provide a level of supervision that is appropriate to the needs of professional and sophisticated investors
- there are no restrictions on investment objectives, risks, currencies or other commercial matters
- there are no requirements for local custodians, managers or directors
- experienced mutual fund professionals and legal counsel are readily available
- the fund vehicle can be quickly and economically established and registered

Umbrella funds offering a variety of investment strategies within one vehicle are common and master/feeder structures are frequently established to offer different types of feeder vehicle to meet the diverse needs of investors.

REGULATORY REGIME

Investment funds are regulated by the Cayman Islands Monetary Authority ("CIMA") under the Mutual Funds Law (2003 Revision). In general, only open-ended funds are regulated and must be registered with CIMA. All registered funds must be audited by a firm of auditors approved by CIMA and located in the Cayman Islands (although there is no objection to the audit fieldwork being conducted elsewhere). Closed-ended funds and, by way of exception, open-ended funds with no more than fifteen investors who, by majority, can appoint or remove the operators of the fund (i.e. directors, trustees or general partners, as the case may be) are not required to be registered.

There are three categories of regulated fund:

Registered Mutual Funds – funds that require a minimum initial investment of at least US$50,000 (i.e. those targeted at institutional or sophisticated high net worth investors) or are listed on an approved stock exchange may be registered on filing the following documentation with CIMA:

- a prospectus which properly describes the equity interest (i.e. shares, units or partnership interests, as the case may be) and contains the information necessary to enable a prospective investor to make an informed decision as to whether or not to subscribe.

- a registration form (Form MF1) and letters of consent from the auditors and administrator
- evidence of incorporation, registration or establishment
- the prescribed registration fee (currently US$3,050)

The majority of regulated funds in the Cayman Islands fall into this category. There is no requirement that the administrator of a registered fund is resident in the Cayman Islands and the emphasis is on self-regulation. However, the fund must have local auditors and the auditors have a statutory obligation to notify CIMA if they become aware or have reason to believe a fund (a) is or is likely to become insolvent, (b) is carrying on business in a manner that is or is likely to be prejudicial to its investors or creditors, or (c) is carrying on business without keeping any or sufficient accounting records to allow its accounts to be audited.

Administered Mutual Funds – funds, including those that permit a minimum initial investment of less than US$50,000, may be established by appointing a licensed mutual fund administrator to provide the principal office of the fund in the Cayman Islands. The administrator has primary regulatory responsibility for the administered fund and has a statutory duty to ensure that the fund is properly administered and that the promoters are of sound reputation. The administrator has a statutory obligation to notify CIMA if it knows or has reason to believe that a fund for which it provides the principal office is or is likely to become insolvent or is carrying on business in a manner that is or is likely to be prejudicial to its investors or creditors. The auditors have a similar statutory obligation as described above for registered funds. Similar documentation to that required for a registered fund must be filed with the Monetary Authority by the licensed administrator in respect of an administered fund and the prescribed fee paid.

Licensed Mutual Funds – funds that are established and operated by large, well-known and reputable institutions may apply for a mutual fund licence. Each director of the fund will be vetted by CIMA and must file a personal questionnaire, financial and character references and police clearance certificate. CIMA must be satisfied that the promoting institution is of sound reputation and that the fund will be properly administered by fit and proper persons with sufficient expertise before a licence will be granted. A current prospectus, registration form and letter of consent from the auditors must also be filed and the prescribed fee paid.

CONSTITUTION AND MANAGEMENT

The constitutional documents (articles of association, trust deed or partnership agreement, as the case may be) of the mutual fund will typically provide for the issue of participating shares or units in multiple classes or series. They will also provide for the operational details including the method and frequency of calculating the net asset value, the procedures for subscription, redemption and conversion between classes, the segregation of assets relating to each class, and the restrictions (if any) on the ownership of shares or units.

Mutual funds are managed by their directors, trustee or general partner, depending on the type of vehicle used. Corporate funds are the most common vehicle and must have at least two directors who are natural persons. However, the day-to-day operations of a mutual fund will normally be delegated to other specialist professionals. The material service contracts will normally include:

- investment management and/or advisory agreement
- administration agreement
- registrar and transfer agency agreement

- custodian agreement and/or prime brokerage agreement

ONGOING REGULATORY OBLIGATIONS

Regulated mutual funds are required to file the following with CIMA on an annual basis:

- prescribed fee to be paid by 15th January
- audited accounts to be filed within six months of the end of the financial year of the fund

Promoters and operators of regulated mutual funds (i.e. directors, trustees or general partners, as the case may be) also have a statutory obligation to notify CIMA:

- of any change that materially affects the information in the prospectus or the registration form of which they are aware and to file an amended prospectus or amended registration form within 21 days
- if the registered office or principal office of the fund has changed
- if the trust company acting has trustee (in the case of a unit trust) has changed

This article is intended to provide a limited overview of the subject matter and is not a substitute for proper legal advice in relation to a particular transaction or proposal.