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SECURITIES INVESTMENT BUSINESS IN THE CAYMAN ISLANDS – a base for fund managers

INTRODUCTION

This article highlights certain considerations and advantages for entities carrying out securities investment business in or from the Cayman Islands.

The Cayman Islands Government, in recognizing the broad diversity of securities investment business, has sensibly avoided adopting a “one size fits all” approach to its regulation. This policy has culminated in the Securities Investment Business Law (2003 Revision) (the “SIBL”), which came into force on 29 July 2003, and provides a balance between the degree of regulation necessary for the protection of lower-end retail or inexperienced investors and the lighter touch appropriate for professional or experienced investors.

It is this approach to regulation in relation to what may generally be termed “sophisticated and wealthy investors” that has made the Cayman Islands an attractive jurisdiction in which to base managers of investment funds. Where the manager (be it of a hedge fund, mutual fund or other type of investment vehicle) is managing investments from or providing advice to either sophisticated or high net worth persons it may, by completing a simple and inexpensive registration process, be exempted from the need to obtain an SIBL licence. This has important ramifications for business professionals who are considering a choice of jurisdictions in which to base either investment funds or the entities responsible for the management of such funds.

APPLICATION

The SIBL applies to all entities organised or established in the Cayman Islands and which are engaged in the course of securities investment business, whether or not that business is actually carried out in or from the Cayman Islands. Under the SIBL “securities investment business” includes dealing in securities, arranging deals in securities, managing securities and advising on securities and “securities” are widely defined to include shares, partnership interests, units in unit trusts, debt instruments, warrants, options, futures and contracts for differences.

LICENSING

All entities to whom the SIBL applies are required to hold a licence appropriate to the securities investment business they intend to conduct in the Cayman Islands, save for those falling within certain exemptions. Applications for a licence are made to the Cayman Islands Monetary Authority (“CIMA”) in the prescribed form and annual licence fees range from US\$2,500 to US\$10,000 depending on the category of licence required. These categories are:

- broker dealer
- broker member
- securities arranger
- securities manager
- securities advisor
- market maker

Anyone who carries on or purports to carry on securities investment business without the appropriate licence is guilty of a criminal offence. The penalties on conviction are severe: up to a year’s imprisonment and a fine of US\$125,000 and, in the case of a continuing offence, a fine of US\$12,500 for each day during which the offence continues.



EXEMPTIONS

A licence is not required where either the business being conducted is an “excluded activity” or, subject to registration with CIMA, the entity conducting the securities investment business is an “excluded person”.

Excluded activities include:

- certain dealings in debt securities;
- issuing, redeeming or repurchasing securities;
- certain transactions relating to employee schemes;
- dealing in securities for the purposes of risk management;
- arranging own deals; and
- provision of finance.

Excluded persons include:

- An entity (with a registered office in the Cayman Islands) carrying on securities investment business exclusively for one or more of the following classes of person:
 - a) a sophisticated person;
 - b) high net worth person; or
 - c) a company, partnership or trust (whether or not regulated as a mutual fund) of which the shareholders, unit holders or limited partners are one or more persons falling within a) or b).
- An entity organised or established in the Cayman Islands that is regulated in respect of securities investment business by a recognised overseas regulatory authority in the country or territory (other than the Islands) in which the securities investment business is being conducted.
- An entity that is regulated in respect of securities investment business by a recognised overseas regulatory authority.
- A company within a group of companies carrying on securities investment business exclusively for one or more companies within the same group.

For the purposes of the SIBL:

A “sophisticated person” means (a) a person who (i) by virtue of knowledge and experience in financial and business matters is reasonably to be regarded as capable of evaluating the merits of a proposed transaction, and (ii) participates in a transaction with a value or in monetary amounts of at least US\$100,000 or its equivalent in any other currency, in the case of each single transaction; or (b) an entity that is regulated by CIMA or by a recognised overseas regulatory authority; or (c) an entity whose securities are listed on a recognised securities exchange.

A “high net worth person” means (a) an individual whose net worth is at least US\$1,000,000 (or its equivalent in any other currency); or (b) any person that has total assets of not less than US\$5,000,000 (or its equivalent in any other currency).



CONCLUSION

The purpose and effect of SIBL, in conjunction with other current Cayman Island legislation, is to strike a balance by loosening the regulatory strings binding those that are experienced and sophisticated enough to make their own investment decisions and allow managers the flexibility to service the needs of such persons.

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.