

Regulation of Investment Funds in the Cayman Islands

Investment fund vehicles established in the Cayman Islands continue to be extremely popular amongst investment managers and investors alike. The Cayman Islands has established a dominant position in the field of offshore investment funds, due to its combination of appropriate regulation, professional service provider expertise, high profile among investors and its tax neutral regime.

Cayman investment funds are formed as Cayman exempted companies, exempted limited partnerships or unit trusts and, depending on their characteristics, can be subject to regulation by the Cayman Islands Monetary Authority (CIMA).

OVERVIEW

Investment funds established in the Cayman Islands fall into two broad categories: closed ended funds and open ended funds. Open ended investment funds are referred to as 'mutual funds' under the Cayman Islands legislation.

Under the Mutual Funds Law (2009 Revision) (MFL) a 'mutual fund' is:

“a company, unit trust or partnership that issues equity interests, the purpose or effect of which is the pooling of investor funds with the aim of spreading investment risks and enabling investors in the mutual fund to receive profits or gains from the acquisition, holding, management or disposal of investments” and an 'equity interest' is a share, trust unit or partnership interest that “carries an entitlement to participate in the profits or gains of the company, unit trust or partnership” and is “redeemable or repurchasable at the option of the investor.”

Generally, mutual funds are subject to regulation under the MFL and Cayman entities acting as manager, advisor or administrator to a mutual fund are also subject to regulation under either the MFL or the Securities Investment Business Law (2004 revision) (SIBL), although advisors and managers commonly fall into an exemption from regulation.

Closed ended funds are not defined in the Cayman Islands legislation; however, CIMA suggests that closed ended funds are funds that have 'no regular redemption date, redemptions in limited circumstances or extensive lock-up periods'.

Closed ended funds are not subject to regulation in the Cayman Islands, although they must have a registered office in the Cayman Islands provided by a regulated entity and, if the advisor or manager is a Cayman entity, they will be subject to regulation or exemption under the SIBL.

MUTUAL FUND REGULATION

The MFL provides for three categories of regulated mutual fund, being “Licensed Funds”, “Administered Funds” and “Registered Funds”, and a category of exempted fund.

Licensed Funds

Licensed Funds are described under section 4(1)(a) of the MFL and are licensed under section 5 of the MFL. A manager would usually choose to license a fund under section 5 if the fund was intended to be a retail fund offered generally to the public outside the Cayman Islands with its administrator and/or manager and other key functionaries outside the Cayman Islands. A Cayman mutual fund that is not eligible for regulation as an Administered Fund or a Registered Fund and is not exempt from regulation must be licensed under section 5 of the MFA.

Licence applications take approximately 4 – 6 weeks from the application being submitted.

Administered Funds

Administered Funds are described under section 4(1)(b) of the MFL. These mutual funds must have a Cayman licensed mutual fund administrator providing the fund’s principal office. The responsibility for regulatory oversight for Administered Funds is largely delegated to the administrator. Notwithstanding this, Administered Funds must be registered with CIMA.

Registration applications take approximately 5 days from the application being submitted.

Registered Funds

Registered Funds are mutual funds which fall within the parameters set out in section 4(3) of the MFL. To qualify as a Registered Fund, the mutual fund must have either (i) a minimum aggregate equity investment of CI\$80,000 (US\$100,000) which is purchasable by a prospective investor in the mutual fund or (ii) its equity interests listed on a stock exchange approved by CIMA (a list is found in Appendix G12 of the Regulatory Handbook). Registered Funds are the Cayman Islands most popular regulated fund. In early 2009 there were more than 9,000 Cayman entities registered as funds under section 4(3).

Registration applications take approximately 5 days from the application being submitted.

Exempted Funds

Certain Cayman entities that would otherwise be subject to licensing or registration are exempt from the requirements of the MFL if they fall within the scope of section 4(4) of the MFL. The categories of mutual funds that are exempt from licensing or registration are:

Cayman Islands mutual funds, the equity interests of which are held by not more than fifteen investors, a majority of whom are capable of appointing or removing

the operator (ie the directors, trustee or general partner) of the fund; and mutual funds not incorporated or established in the Cayman Islands which make an invitation to the public to subscribe for equity interests in the Cayman Islands by or through a person who is the holder of a licence under the SIBL for a regulated activity specified by CIMA for the purposes of the exemption and which interests are either listed on an approved stock exchange or are regulated by a non-Cayman Islands regulator approved by CIMA for the purposes of the exemption.

Where a mutual fund falls with the scope of the exemption in section 4(4) of the MFL that fund is not subject to regulation by CIMA.

GENERAL PROVISIONS

Location of Functionaries

Save for Administered Funds, there is no requirement that a mutual fund's functionaries be based in the Cayman Islands or in any prescribed jurisdiction. However, mutual funds are limited to delegating their anti-money laundering compliance to administrators based in a jurisdiction identified in Schedule 3 to the Guidance Notes on the Prevention and Detection of Money laundering in the Cayman Islands (the "Guidance Notes") (see appendix 1 for a current list). This means, in practical terms, that administrators of Cayman mutual funds usually operate out of a Schedule 3 jurisdiction.

Registered Office

All Cayman Islands companies and limited partnerships must have a registered office in the Cayman Islands provided by a person licensed under the Companies Management Law (2003 Revision) or the Banks and Trust Companies Law (2007 Revision).

AML Delegation

CIMA has indicated in the Guidance Notes (Section 8 – Mutual Funds Sector Guidance) that it will accept the delegation by a mutual fund of its anti-money laundering obligations to an administrator that is subject to a Schedule 3 jurisdiction's anti money laundering regime and will regard compliance with the anti-money laundering regime of that Schedule 3 jurisdiction by the administrator as compliance by the mutual fund with the Cayman Islands anti-money laundering regime, provided that:

- details of the delegation agreement and written evidence of the suitability of the administrator (or its employees) to perform the relevant functions on behalf of the mutual fund are available to CIMA on request;
- there is a clear understanding between the administrator and the mutual fund of the functions to be performed by the administrator;
- the relevant customer information is readily available to CIMA on request and to the Financial Reporting Unit and other law enforcement authorities; and
- the mutual fund satisfies itself on a regular basis as to the administrator's systems and procedures.

A current list of the Schedule 3 Jurisdictions is contained at Appendix 1.

Offering Document Requirements

The MFL describes an offering document as the document or series of documents on the basis of which equity interests in the mutual fund are offered for sale or persons are invited to subscribe for or purchase equity interests.

Section 4(6) of the MFL prescribes that the offering document of a regulated fund describe the equity interests in all material respects and contain such other information as is necessary to enable a prospective investor in the mutual fund to make an informed decision as to whether or not to subscribe for or purchase the equity interests.

Local Auditor Sign-off and FAR

All Cayman Islands regulated funds (that is all Licensed, Administered and Registered Funds) must submit annual accounts to CIMA which have been audited and which audit has been signed off by a Cayman Islands based auditor within 6 months of the end of the fund's financial year.

CIMA has the discretion, under section 8(4) of the MFL, to exempt regulated mutual funds from submitting audited accounts if there is a valid reason for the mutual fund not wishing to submit audited accounts. Examples of such reasons may include where the fund has never accepted any subscriptions and never traded. Not wishing to incur the costs of an audit will not be regarded as a valid reason.

Each regulated fund must also, together with their annual accounts, submit a Fund Annual Return (or FAR) to CIMA in the approved form. This is generally submitted electronically by the fund's Cayman Islands auditor.

Other Ongoing Obligations

1. All regulated mutual funds must inform CIMA of any change that materially affects any information in the offering document and must file with CIMA an amended offering document incorporating such changes.
2. All regulated mutual funds must inform CIMA of any change in their registered office or principal office.
3. All regulated mutual funds must pay the annual fee by 15th January of each year. If an annual fee is not paid by the 15th of January of each year, a penalty of 1/12th of the annual fee will be payable for each month or part of a month during which the annual fee and any penalty remains unpaid.
4. All regulated mutual funds must inform CIMA of changes in auditor, or change of name.

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FURTHER INFORMATION

Please contact any of the following Harneys lawyers if you require additional information on our Cayman Islands mutual funds practice.

Cayman Islands

Kieron O'Rourke
Partner
kieron.orourke@harneys.com
+1 345 949 8599

Cayman Islands

Jonathan Law
Partner
jonathan.law@harneys.com
+1 345 815 2931

London

Jonathan Culshaw
Partner
jonathan.culshaw@harneys.com
+44 (0) 207 842 6085

Cayman Islands / Montevideo

Marco Martins
Partner
marco.martins@harneys.com
Cayman: +1 345 815 2932
Montevideo: +59 82 518 2238

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Appendix 1

Schedule 3 Jurisdictions

Argentina	Israel
Australia	Italy
Austria	Japan
Bahamas	Jersey
Bahrain	Liechtenstein
Barbados	Luxembourg
Belgium	Malta
Bermuda	Mexico
Brazil	Netherlands
British Virgin Islands	New Zealand
Canada	Norway
Denmark	Panama
Finland	Portugal
France	Singapore
Germany	Spain
Gibraltar	Sweden
Greece	Switzerland
Guernsey	Turkey
Hong Kong	United Arab Emirates
Iceland	United Kingdom
Ireland	United States of America
Isle of Man	